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OSI SYSTEMS INC

FORM 10-Q
(Quarterly Report)

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON DC 20549

FORM 10-Q
(MARK ONE)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 1998

OR

[_] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____ to ____

Commission File Number 0-23125

OSI SYSTEMS, INC.
(Exact name of Registrant as specified in its charter)

CALIFORNIA (State or other jurisdiction of incorporation or organization)	33-0238801 (I.R.S. Employer Identification Number)

12525 Chadron Avenue
Hawthorne, California 90250
(Address of principal executive offices)

Registrant's telephone number, including area code: (310) 978-0516

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period as the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past ninety days.

YES X NO

As of November 10, 1998 there were 9,711,040 shares of common stock outstanding.

OSI SYSTEMS, INC.

INDEX

	PAGE NUMBER
PART I - FINANCIAL INFORMATION	
Item 1 - Consolidated Financial Statements	
Consolidated Balance Sheets at September 30, 1998 and June 30, 1998 (Unaudited)	3
Consolidated Statements of Operations for the three months ended September 30, 1998 and September 30, 1997 (Unaudited)	4
Consolidated Statements of Cash Flows for the three months ended September 30, 1998 and September 30, 1997 (Unaudited)	5
Notes to Consolidated Financial Statements (Unaudited)	6
Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations	9
PART II - OTHER INFORMATION	
Item 6 - Exhibits and Reports on Form 8-K	14
Signatures	14

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

OSI SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

(Unaudited)

	September 30, 1998	June 30, 1998
ASSETS		
Current Assets:		
Cash and cash equivalents	$17,498	$22,447
Marketable securities available for sale	1,598	
Accounts receivable, net of allowance for doubtful accounts of $1,072 and $551 at September 30, 1998 and June 30, 1998, respectively	23,736	24,254
Other receivables	2,592	1,990
Inventory	25,888	21,705
Prepaid expenses	1,191	841
Deferred income taxes	1,381	1,381
Total current assets	73,884	72,618
Property and Equipment, Net	12,983	11,466
Intangible and Other Assets, Net	9,625	2,738
Total	$96,492	$86,822
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Bank lines of credit	$ 6,600	$ 198
Current portion of long-term debt	571	633
Accounts payable	8,802	8,560
Accrued payroll and related expenses	2,058	2,400
Income taxes payable	2,681	2,517
Advances from customers	1,558	1,808
Accrued warranties	1,925	1,948
Other accrued expenses and current liabilities	3,552	2,137
Total current liabilities	27,747	20,201
Long-Term Debt	166	412
Deferred Income Taxes	296	294
Total liabilities	28,209	20,907
Shareholders' Equity		
Preferred stock, no par value; authorized, 10,000,000 shares; none issued and outstanding at September 30, 1998 and June 30, 1998, respectively		
Common stock, no par value; authorized, 40,000,000 shares; issued and outstanding 9,694,915 and 9,691,915 shares at September 30, 1998 and June 30, 1998, respectively	49,140	49,131
Retained earnings	19,079	17,419
Unrealized gain on marketable securities available for sale	167	
Cummulative foreign currency translation adjustment	(103)	(635)
Total shareholders' equity	68,283	65,915
Total	$96,492	$86,822

See accompanying notes to consolidated financial statements

OSI SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

(UNAUDITED)

	THREE MONTHS ENDED SEPTEMBER 30,	
	1998	1997
Revenues	$21,404	$22,961
Cost of goods sold	14,988	16,649
Gross profit	6,416	6,312
Operating expenses:		
Selling, general and administrative	3,389	3,099
Research and development	1,024	827
Total operating expenses	4,413	3,926
Income from operations	2,003	2,386
Interest (income)/expense, net	(167)	411
Income before provision for income taxes	2,170	1,975
Provision for income taxes	510	534
Net income	$ 1,660	$ 1,441
Earnings per common share	$ 0.17	$ 0.23
Earnings per common share, assuming dilution	$ 0.17	$ 0.22

See accompanying notes to consolidated financial statements

OSI SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Three months ended September 30,	
	1998	1997
Cash flows from operating activities:		
Net income	$ 1,660	$ 1,441
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	645	597
Changes in operating assets and liabilities:		
Accounts receivable	2,384	(2,780)
Other receivables	(487)	(191)
Inventory	(1,837)	(1,006)
Prepaid expenses	(335)	(409)
Accounts payable	(54)	772
Accrued payroll and related expenses	(912)	(377)
Income taxes payable	112	312
Advances from customers	(280)	(128)
Accrued warranty	(115)	
Other accrued expenses and current liabilities	340	509
Net cash provided by (used in) operating activities	1,141	(1,260)
Cash flows from investing activities:		
Additions to property and equipment	(1,584)	(620)
Addition to marketable securities available for sale	(1,431)	
Cash paid for business acquisitions, net of cash acquired	(8,663)	
Other assets	(487)	71
Net cash used in investing activities	(12,175)	(549)
Cash flows from financing activities:		
Net proceeds from bank lines of credits	6,400	3,551
Payments on long-term debt	(356)	(275)
Proceeds from exercise of stock options and warrants	9	245
Net cash provided by financing activities	6,053	3,521
Effect of exchange rate changes on cash	24	(80)
Net (decrease) increase in cash	(4,957)	1,632
Cash or cash equivalents, beginning of period	22,455	553
Cash or cash equivalents, end of period	$ 17,498	$ 2,185
Supplemental disclosures of cash flow information - Cash (received)/paid during the period for:		
Interest	$ (239)	$ 372
Income taxes	$ 394	$ 344

During the period ended September 30, 1997 the company acquired property and equipment under extended financing terms in the amount of $708,000.

In September 1998, the Company acquired all of the capital stock of Osteometer MediTech A/S. In conjunction with the acquisition, liabilities were assumed as follows:

Fair value of assets acquired	$ 4,087
Goodwill and intangible assets	5,387
Cash paid for the capital stock	(7,750)
Liabilities assumed	$ 1,724

See accompanying notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General - OSI Systems, Inc. and its subsidiaries (collectively, the "Company") is a vertically integrated worldwide provider of devices, subsystems and end- products based on optoelectronic technology. The Company designs and manufactures optoelectronic devices and value-added subsystems for original equipment manufacturers in a broad range of applications, including security, medical diagnostics, telecommunications, gaming, office automation, aerospace, computer peripherals and industrial automation. In addition, the Company utilizes its optoelectronic technology and design capabilities to manufacture security and inspection products that it markets worldwide to end users under the "Rapiscan" and "Secure" brand names. These products are used to inspect people, baggage, cargo and other objects for weapons, explosives, drugs and other contraband.

Consolidation - The consolidated financial statements include the accounts of OSI Systems, Inc. and its majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The consolidated balance sheet as of September 30, 1998, the consolidated statements of operations and the consolidated statements of cash flows for the three-month periods ended September 30, 1998 and 1997 have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the "Commission"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. However, in the opinion of management all adjustments, consisting of only normal and recurring adjustments, necessary for a fair presentation of the financial position and the results of operations for the periods presented have been included. These consolidated financial statements and the accompanying notes should be read in conjunction with the audited consolidated financial statements and accompanying notes for the fiscal year ended June 30, 1998 included in the Company's Annual Report on Form 10K as filed with the Commission on September 28, 1998. The results of operations for the three months ended September 30, 1998 are not necessarily indicative of the results to be expected for the fiscal year ending June 30, 1999.

Recent Developments - On September 2, 1998, the Company acquired all the outstanding capital stock of Osteometer MediTech A/S ("Osteometer"), a Danish manufacturer of densitometers used for scanning osteoporosis, for $7.75 million in cash. During the quarter ended September 30, 1998, the Company also made investments in the aggregate amount of approximately $800,000 in two other businesses.

Subsequent to the quarter ended September 30, 1998, the Company purchased a security products business unit from Metorex International Oy of Espoo, Finland for approximately $6.0 million, $4.5 million of which was paid at the closing and up to $1.5 million of which may be paid at a later date, based on future sales.

Intangible And Other Assets, Net - The Company paid $7.75 million for the acquisition of Osteometer, a Danish company, in September 1998. Costs in excess of net tangible assets acquired of $5.4 million have been included in Intangible and Other Assets on the accompanying balance sheet pending completion of a valuation study. The Company believes that a significant portion of this amount relates to in-process research and development, which will be charged to expense after the valuation has been completed, currently expected to be in the second quarter.

Foreign Exchange Instruments - The Company's use of derivatives is limited to the purchase of foreign exchange contracts in order to minimize foreign exchange transaction gains and losses. The Company purchases forward contracts to hedge commitments to acquire inventory for sale and does not use the contracts for trading purposes. Realized gains and losses on these contracts are recognized in the same period as the hedged transactions. The forward exchange contracts related to inventory purchases are recognized as adjustments to the bases of the underlying assets. As of September 30, 1998 and June 30, 1998 there was approximately $988,000 and $973,000, respectively, in outstanding foreign exchange contracts. At September 30, 1998 and June 30, 1998, there were no carrying amounts related to foreign currency contracts on the consolidated balance sheets. The fair values of foreign exchange contracts are estimated by obtaining quotes from brokers. At September 30, 1998 and June 30, 1998, the carrying amount and fair value of these contracts were not material to the consolidated financial statements.

Inventory - Inventory is stated at the lower of cost or market; cost is determined on the first-in, first-out method.

Inventory at September 30, 1998 and June 30, 1998 consisted of the following (in thousands):

	SEPTEMBER 30, 1998	JUNE 30, 1998
Raw Materials	$15,273	$12,200
Work-in-process	7,024	6,030
Finished goods	3,591	3,475
Total	$25,888	$21,705

Earnings Per Share - Earnings per common share is computed using the weighted average number of shares outstanding during the period. Earnings per common share, assuming dilution, is computed using the weighted average number of shares outstanding during the period and dilutive common stock equivalents from the Company's stock option plans.

The following table reconciles the numerator and denominator used in calculating earnings per common share and earnings per common share, assuming dilution.

	For the Quarter ended September 30, 1998					
	1998			1997		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Earnings per common share						
Income available to common stockholders	$1,660,000	9,693,165	$0.17	$1,441,000	6,181,028	$0.23
Effect of Dilutive Securities						
Options, treasury stock method		153,506			291,011	
Earnings per common share assuming dilution						
Income available to common stockholder, assuming dilution	$1,660,000	9,846,671	$0.17	$1,441,000	6,472,039	$0.22

Comprehensive Income - In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 130 "Reporting for Comprehensive Income" (SFAS No. 130), which the Company adopted in the first quarter of fiscal 1999. SFAS No. 130 establishes standards for reporting and displaying comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income is computed as follows (in thousands):

	For the Quarter ended September 30, 1998	
	1998	1997
Net income	$1,660	$1,441
Other comprehensive income, net of taxes:		
Foreign currency translation adjustments	(103)	(193)
Unrealized gains on marketable securities available for sale	167	
Other comprehensive income	64	(193)
Comprehensive income	$1,724	$1,248

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

CAUTIONARY STATEMENT

STATEMENTS IN THIS REPORT THAT ARE FORWARD-LOOKING ARE BASED ON CURRENT EXPECTATIONS, AND ACTUAL RESULTS MAY DIFFER MATERIALLY. FORWARD-LOOKING STATEMENTS INVOLVE NUMEROUS RISKS AND UNCERTAINTIES THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY, INCLUDING, BUT NOT LIMITED TO, THE POSSIBILITIES THAT THE DEMAND FOR THE COMPANY'S PRODUCTS MAY DECLINE AS A RESULT OF POSSIBLE CHANGES IN GENERAL AND INDUSTRY SPECIFIC ECONOMIC CONDITIONS AND THE EFFECTS OF COMPETITIVE PRICING AND SUCH OTHER RISKS AND UNCERTAINTIES AS ARE DESCRIBED IN THIS REPORT ON FORM 10-Q AND OTHER DOCUMENTS PREVIOUSLY FILED OR HEREAFTER FILED BY THE COMPANY FROM TIME TO TIME WITH THE SECURITIES AND EXCHANGE COMMISSION.

RESULTS OF OPERATIONS

Revenues. Revenues consist of sales of optoelectronic devices and subsystems and security and inspection products. Revenues are recorded net of all inter-company eliminations. Revenues for the three months ended September 30, 1998 decreased by $1.6 million, or 6.8%, to $21.4 million from $23.0 million for the three months ended September 30, 1997. Revenues for the three months ended September 30, 1998 from security and inspection products were $7.8 million or approximately 36.4% of the Company revenues, and revenues from sales of optoelectronic devices and subsystems were $13.6 million or approximately 63.6% of the Company's revenues. Revenues from sales of optoelectronic devices and subsystems increased, both in absolute dollars and as a percentage of total company revenues, as a result of an increase in sales to the medical diagnostic industry. Revenues from sales of security and inspection products decreased largely because of delayed shipments of certain large cargo scanning machines under one contract.

Gross Profit. Cost of goods sold consists of material, labor and manufacturing overhead. Gross profit increased by $104,000, or 1.6%, to $6.4 million for the three months ended September 30, 1998 from $6.3 million for the three months ended September 30, 1997. As a percentage of revenues, gross profit increased to 30.0% for three months ended September 30, 1998 from 27.5% for the three months ended September 30, 1997. The increase in gross margin was mainly due to increased manufacturing efficiencies and product mix.

Selling, General and Administrative. Selling, general and administrative expenses consisted primarily of compensation paid to sales, marketing, and administrative personnel, professional service fees, and marketing expenses. For the three months ended September 30, 1998, such expenses increased by $290,000 or 9.4%, to $3.4 million from $3.1 million for the three months ended September 30, 1997. As a percentage of revenues, selling, general and administrative expenses increased to 15.8% for the three

months ended September 30, 1998 from 13.5% for the three months ended September 30, 1997. The increase in expenses was due primarily to the inclusion of Osteometer's selling, general and administrative expenses in the Company's consolidated financial statements commencing September 1998, and an increase in marketing expenses to penetrate new markets.

Research and Development. Research and development expenses include research related to new product development and product enhancement expenditures. For the three months ended September 30, 1998, such expenses increased by $197,000 or 23.8% compared to $1.0 million from $827,000 for the three months ended September 30, 1997. As a percentage of revenues, research and development expenses increased to 4.8% from 3.6%. The increase was due primarily to acceleration of certain research and development projects and increased efforts to develop products for cargo scanning and an operator training system known as Screener Proficiency Evaluation And Reporting System.

Income from Operations. Income from operations for the three months ended September 30, 1998, decreased by $383,000 or 16.1% to $2.0 million from $2.4 million for the three months ended September 30, 1997. As a percentage of revenues, income from operations decreased to 9.4% from 10.4% for the reasons discussed under Selling, General and Administrative Expenses and Research and Development.

Interest Expense. For the three months ended September 30, 1998, the Company earned net interest income of $167,000 compared to net interest expense of $411,000 for the three months ended September 30, 1997. The net interest income was due to short term investments of the remaining proceeds from the initial public offering of the Company's common stock in October 1997.

Provision for Income Taxes. Provision for income taxes decreased to $510,000 for the three months ended September 30, 1998 from $534,000 for the comparable prior year quarter. As a percentage of income before provision for income taxes, provision for income taxes decreased in the quarter to 23.5% this year from 27.0% last year. The decrease was a result of increased utilization of research and development credits and a lower tax rate on certain products shipped by the Company's wholly owned subsidiary Opto Sensors (Malaysia) Sdn. Bhd.

Net Income. For the reasons outlined above, net income for the three months ended September 30, 1998 increased by 15.2% to $1.7 million compared to $1.4 million for the comparable prior year period.

LIQUIDITY AND CAPITAL RESOURCES

The Company's operations provided net cash of $1.1 million during the three months ended September 30, 1998. The amount of net cash provided by operations reflects reductions in accounts receivable and increases in income taxes payable and other accrued expenses and current liabilities. Net cash provided by operations was offset in

part by increases in inventory, other receivables, prepaid expenses and reduction in accrued payroll and related expenses, advances from customers and accrued warranty.

The reduction in accounts receivable is mainly due to the collection of amounts due under certain large contracts. Net cash used in investing activities was $12.2 million and $549,000 for the three months ended September 30, 1998 and 1997, respectively. In the period ended September 30, 1998, the net cash used in investing activities reflects primarily cash used in business acquisitions, purchases of property and equipment, and purchase of marketable securities available for sale. In the period ended September 30, 1997, the net cash used in investing activities reflects primarily the purchase of property and equipment. In the period ended September 30, 1998, $8.7 million was used for the acquisition of Osteometer and an investment in two businesses as well as professional fees associated with the acquisition and investments. Of the total property and equipment purchases, approximately $700,000 was for the purchase of equipment to manufacture products used in the oil exploration field.

Net cash provided by financing activities was $6.1 million and $3.5 million for the three months ended September 30, 1998 and 1997, respectively, in each case primarily in the form of net borrowing from bank lines of credit.

The Company anticipates that current cash balances, anticipated cash flows from operations and current borrowing arrangements will be sufficient to meet its working capital and capital expenditure needs for the foreseeable future.

Foreign Currency Translation. The accounts of the Company's operations in Singapore, Malaysia, England, Denmark and Norway are maintained in Singapore dollars, Malaysian ringgits, U.K. pounds sterling, Danish kroner and Norwegian kroner, respectively. Foreign currency financial statements are translated into U.S. dollars at current rates, with the exception of revenues, costs and expenses, which are translated at average rates during the reporting period. Gains and losses resulting from foreign currency transactions are included in income, while those resulting from translation of financial statements are excluded from income and accumulated as a component of shareholder's equity. Net transaction gains of approximately $47,000 and $74,000 were included in income for the three months ended September 30, 1998 and 1997, respectively.

Inflation. The Company does not believe that inflation has had a material impact on its September 30, 1998 results of operations.

Year 2000 Compliance. The Company has a comprehensive Year 2000 project designed to identify and assess the risks associated with its information systems, products, operations and infrastructure, suppliers, and customers that are not Year 2000 compliant, and to develop, implement, and test remediation and contingency plans to mitigate these risks. The project, comprises four phases:
(1) identification of risks, (2) assessment of risks, (3) development of remediation and contingency plans, and (4) implementation and testing.

The Company's Year 2000 project is currently in the assessment phase and, with respect to certain information systems and products, is in the remediation phase. The Company's Year 2000 project is being spearheaded by a special task force comprised of a senior management team as well as other key personnel. The task force meets on a regular basis to determine and implement the steps necessary to insure that the Company becomes fully Year 2000 compliant.

The Company has upgraded its critical database and believes that it is Year 2000 compliant. The financial records of the Company's principal U.S. subsidiaries, Rapiscan Security Products, (U.S.A.) Inc. and UDT Sensors, Inc. have also been upgraded and are Year 2000 compliant. The financial records model will be made uniform throughout the Company on a worldwide basis; the estimated completion date for this upgrade is on or before June 30, 1999. The Company has completed an upgrade of the telephone systems, including voice-mail software, for Rapiscan U.S.A. and UDT Sensors. The cost of these upgrades to date has not been material. The Enterprise Resource Planning software used by several of the Company's operating subsidiaries has been certified as Year 2000 compliant.

The Company is in the assessment and remediation phase of determining Year 2000 compliance of its own products, which are dependent on third party suppliers and vendors for critical parts. The Company expects to complete this assessment by March 31, 1999 and expects to be able to complete remediation as required by June 30, 1999. Based on what the Company knows at this time, DOS and Windows 95 are not Year 2000 compliant; therefore, the Company's products which rely on these products are themselves not Year 2000 compliant. The Company intends to upgrade this software to Year 2000 compliant versions. The Company's products which are not presently Year 2000 compliant are not affected in terms of performance in any material respect; however, archiving of information may be affected by Year 2000 noncompliance. The Company's exposure is with respect to its products under warranty which were manufactured prior to the software upgrade. In such cases, the Company would offer its customers a software upgrade to a Year 2000 compliant version. Until the assessment phase is completed, the Company is not in a position to know if the costs of upgrading the software used in the manufacture of its products or offering its customers such upgrading will be material.

The Company expects to have completed by March 31, 1999 a full assessment of all hardware, operating systems and software applications in use on a worldwide basis. Some upgrading is expected to be required, including upgrading to a uniform operating system on a Company-wide basis. The costs of such assessment and upgrading are not expected to be material. Required upgrading is expected to be completed on or before June 30, 1999. In addition, the Company is in the process of obtaining Year 2000 compliance statements from the manufacturers of the Company's hardware and software products.

The Company believes that its greatest potential risks are associated with (i) its information systems and systems embedded in its operations and infrastructure; and (ii) its reliance on Year 2000 compliance by the Company's vendors and suppliers. The Company is at the beginning stage of assessments for its operations and infrastructure, and cannot predict

whether significant problems will be identified. The Company is asking its critical vendors and suppliers to complete a Year 2000 survey to assess the status of their compliance in order to assess the effect it could have on the Company. The Company expects that all such surveys will be distributed to vendors by December 31, 1998. The Company has not yet determined the full extent of contingency planning that may be required. Based on the status of the assessments made and remediation plans developed to date, the Company is not in a position to state the total cost of remediation of all Year 2000 issues. Costs identified to date have not been material. The Company does not currently expect the total costs to be material, and it expects to be able to fund the total costs through operating cash flows. However, the Company has not yet completed its assessments, developed remediation for all problems, developed any contingency plans, or completely implemented or tested any of its remediation plans.

Based on the Company's current analysis and assessment of the state of its Year 2000 compliance, the Company's most reasonably likely worst case scenario involves delays in shipping of parts, including critical parts, by certain of the Company's vendors and suppliers. Such delays could cause the Company to experience delays in shipping its products. Specific contingency plans will be formulated after the Company has received compliance surveys back from its vendors and suppliers but could include, among other things, increasing inventory of critical parts in late 1999 to insure an adequate supply is on hand to minimize shipping delays by the Company of its products.

As the Year 2000 project continues, the Company may discover additional Year 2000 problems, may not be able to develop, implement, or test remediation or contingency plans, or may find that the costs of these activities exceed current expectations and become material. In many cases, the Company is relying on assurances from suppliers that new and upgraded information systems and other products will be Year 2000 compliant. The Company plans to test such third-party products, but cannot be sure that its tests will be adequate or that, if problems are identified, they will be addressed in a timely and satisfactory way. Because the Company uses a variety of information systems and has additional systems embedded in its operations and infrastructure, the Company cannot be sure that all of its systems will work together in a Year 2000 compliant fashion. Furthermore, the Company cannot be sure that it will not suffer business interruptions, either because of its own Year 2000 problems or those of its customers or suppliers whose Year 2000 problems may make it difficult or impossible for them to fulfill their commitments to the Company. If the Company fails to satisfactorily resolve Year 2000 issues related to its products in a timely manner, it could be exposed to liability to third parties. The Company is continuing to evaluate Year 2000-related risks and will take such further corrective actions as may be required.

PART II OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a. Exhibits

10.22 Cooperative Research and Development Agreement dated May 13, 1998 between Rapiscan Security Products, Inc. and the Federal Aviation Administration (portions of this exhibit have been omitted pursuant to a request for confidential treatment filed with the Secuities and Exchange Commission).

27. Financial Data Schedule

b. Reports on Form 8-K

None

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, in the City of Hawthorne, State of California on the 13th day of November 1998.

OSI Systems, Inc.

By: /s/ Deepak Chopra
_____
Deepak Chopra
President and
Chief Executive Officer

By: /s/ Ajay Mehra
_____
Ajay Mehra
Vice President and
Chief Financial Officer

EXHIBIT 10.22

COOPERATIVE RESEARCH AND DEVELOPMENT AGREEMENT

97-CRDA-0106

RAPISCAN SECURITY PRODUCTS, INC.

AND

THE FEDERAL AVIATION ADMINISTRATION
WILLIAM J. HUGHES TECHNICAL CENTER

This Cooperative Research and Development Agreement (CRDA), dated _____ is entered into by and between Rapiscan Security Products, Inc. [RAPISCAN], and the United States of America, as represented by the Federal Aviation Administration William J. Hughes Technical Center [FAA Technical Center], located at the Atlantic City International Airport, New Jersey.

A. BACKGROUND

The development of effective enhanced automated baggage screening systems is a continuing effort at the Federal Aviation Administration (FAA) Technical Center. The Aviation Security Research & Development Division has been examining the potential of several technologies and is particularly interested in further development of the X-ray measurement and analysis techniques currently under development by Rapiscan. The Rapiscan technology is unique and proprietary in its particular scanning approach as well as in its image processing ability to sort out the signatures of numerous objects within a typical piece of luggage and then to identify to an operator whether a particular object constitutes a threat (explosive). The technology has been developed to the point where it is approaching the capability to meet the detection and throughput requirements for enhanced automated inspection of luggage at an airport.

B. OBJECTIVE AND PLAN

The intent of this CRDA is to assist Rapiscan to optimize its prototype enhanced automated X-ray baggage screening system for use at airports.

C. AGREEMENT

The Federal Technology Transfer Act of 1986, as amended, 15 U.S.C. 371Oa, et seq. permits the Director of the FAA Technical Center to enter into Cooperative Research and Development Agreements consistent with that Act, associated Executive Orders, and agency policies.

ARTICLE 1. Definitions

As used in this AGREEMENT, the following terms shall have the following meanings:

1.0 The term "AGREEMENT" means this Cooperative Research and Development Agreement, or"CRDA".

1.1 The term "Cooperative Research and Development Program" means the research and development work as defined in the Obligation of the Parties (OP) in Article 2, paragraph 2.1.

1.2 The term "effective date" means the date on which the Director of the FAA Technical Center signs the AGREEMENT.

1.3 The term "made" in relation to any invention means the conception or first actual reduction to practice of such invention.

1.4 The term "invention" means any invention or discovery (including software- related invention) which is or may be patentable or otherwise protected under Title 35 of the United States Code or any novel variety of plant which is or may be protectable under the Plant Variety Protection Act (7 U.S.C. 7321 et seq.).

1.5 The term "proprietary information" means information which could provide a competitive advantage to the party possessing such information and which either embodies trade secrets developed at private expense and outside of any Government contract or is confidential technical, business, or financial information provided that such information:

a) is not generally known, or is not available from other sources without obligations concerning its confidentiality;
b) has not been made available by the owners to others without obligations concerning its confidentiality; or,
c) is not already available to the public without obligations concerning its confidentiality.

1.6 "Subject invention" means any invention conceived or first actually reduced to practice in the performance of work under this AGREEMENT (as described in
Section 2.0 of the Obligations of the Parties attached hereto as Appendix A), but shall not include any invention conceived and first actually reduced to practice prior to the date hereof.

1.7 The term "created" in relation to any copyrightable software work means when the work is fixed in any tangible medium of expression for the first time, as provided for at 17 U.S.C. 101.

ARTICLE 2. Cooperative Research and Development Program

2.1 Obligation of the Parties. The cooperative research and development program performed under this AGREEMENT shall be performed in accordance with the Obligations of the Parties [OP], attached as Appendix A. The utilization of the FAA Technical Center's personnel, resources, facilities, equipment, skills, know-how, computer software and information will be consistent with its own policies, missions, and requirements. It is understood that the nature of this cooperative research is such that completion within the period of performance specified, or within the limits of financial support allocated, cannot be guaranteed. Accordingly, it is agreed that all cooperative research is to be performed on a best efforts basis. Any modifications of the OP shall be by mutual agreement between the parties and shall be incorporated into this AGREEMENT by a formally executed written amendment.

2.2 Review of Work. Periodic conferences may be held, when deemed necessary by both parties, between personnel of the FAA Technical Center and RAPISCAN for the purpose of reviewing the progress of work defined in the OP of paragraph 2.1.

2.3 Principal Investigator. The Aviation Security Research & Development Division agrees to assign a substantial portion of the work to be performed pursuant to the OP to the Aviation Security Research & Development Division, AAR-500, AAR-520. The work will be performed under the supervision of Roy Mason who, as Principal Investigator, has the responsibility for the scientific and technical conduct of this project.

2.4 Scope Change. If at any time the Principal Investigator determines that the research data dictates a substantial change in the direction of the work, the FAA Technical Center shall promptly notify RAPISCAN and the parties shall make a good faith effort to agree on any necessary change to the OP. Any substantial change in the direction of work will be formalized by a mutual agreement and a change to the OP that specifies the new work to be performed, in each case signed by the FAA and by the chairman or president of RAPISCAN.

ARTICLE 3. Reports

The FAA Technical Center shall prepare quarterly and final reports. These reports shall follow the guidelines in Appendix B. The final report shall be prepared within three (3) months after completing the work called for in the OP. Copies of all reports shall be forwarded to AAR-201. Any other reports as called for in the OP shall be in a format agreed upon by RAPISCAN and the PI and shall be forwarded to RAPISCAN and AAR-201.

ARTICLE 4. Financial Obligation

The performance of research by the FAA Technical Center under this AGREEMENT is not conditioned on any advance payment of funds by RAPISCAN.

ARTICLE 5. Term

The term of this AGREEMENT is for a period of 36 months, commencing on the effective date of this AGREEMENT, unless otherwise modified pursuant to Article 13.

ARTICLE 6. Title to Property

6.1 Capital Equipment. All capital equipment developed, acquired, and funded under this AGREEMENT by the FAA Technical Center shall be the property of the FAA Technical Center, except that title to items of capital equipment provided to the FAA Technical Center by RAPISCAN or acquired by the FAA Technical Center with funds supplied by RAPISCAN (including without limitation, x-ray machines and related equipment) shall remain or vest in RAPISCAN.

6.2 Software. Title to software developed by RAPISCAN exclusively at private expense shall remain in RAPISCAN. Except to the extent that such software may be patentable, the Government acquires no rights to software developed by RAPISCAN in the course of participating in this AGREEMENT. Rights acquired in patentable software are set out in Article 9.

ARTICLE 7. Publicity, Use of Name, and Endorsement

7.1 Use of Technical Center Name Prohibited. RAPISCAN shall not use the name of the FAA Technical Center on any product or service which is directly or indirectly related to either this AGREEMENT or any patent license or assignment Agreement which implements this AGREEMENT without the prior approval of the FAA Technical Center.

7.2 No Endorsement by FAA. By entering into this AGREEMENT, the FAA Technical Center does not directly or indirectly endorse any product or service provided, or to be provided, by RAPISCAN, its successors, assignees, or licensees. RAPISCAN shall not in any way imply that this AGREEMENT is an endorsement by the FAA Technical Center of any such product or service.

7.3 Publicity. Notwithstanding Articles 7.1 and 7.2 of this AGREEMENT, RAPISCAN may publicly disclose the existence of this AGREEMENT, a general discussion of the services to be performed by the FAA Technical Center hereunder and such other information as it determines reasonably necessary for compliance with applicable securities laws or listing agreements affecting its parent corporation.

ARTICLE 8. Publication

The FAA Technical Center and RAPISCAN agree to confer and consult with each other prior to publication or other public disclosure of the results of work under this AGREEMENT to ensure that no proprietary information or military critical technology is released. Furthermore, prior to submitting a manuscript for publication or before any other public disclosure, each party will offer the other party ample opportunity to review such

proposed publication or disclosure, to submit objections, and to file patent applications in a timely manner.

Notwithstanding the foregoing, RAPISCAN may make such public disclosures as it determines reasonably necessary to satisfy applicable securities laws or listing agreements affecting its parent corporation without first submitting such public disclosure to the FAA Technical Center; provided, however, that a copy of such disclosure shall thereafter be provided to the FAA Technical Center.

ARTICLE 9. Patents

9.1 Reporting of Inventions. The FAA Technical Center shall promptly report to RAPISCAN each subject invention reported to the FAA Technical Center by its employees. RAPISCAN shall promptly disclose to the FAA Technical Center each subject invention reported to RAPISCAN by any of its employees. Each party shall provide the other party with copies of the patent applications it files on any subject invention along with the power to inspect and make copies of all documents retained in the official patent application files by the applicable patent office, except as may be prohibited by 35 U.S.C. 181, relating to inventions affecting the national security.

9.2 Inventions Made Solely by Employees of RAPISCAN. The FAA Technical Center, on behalf of the U.S. Government, waives any ownership rights the U.S. Government may have in subject inventions made solely by RAPISCAN employees and agrees that RAPISCAN shall have the option to retain title to any such employee subject invention. RAPISCAN shall notify the FAA Technical Center promptly upon making this election and agrees to file timely patent applications on such subject invention at its own expense in such countries which RAPISCAN, in its own discretion, deems expedient. Nothing in this AGREEMENT shall be interpreted to require RAPISCAN to continue the prosecution of such patents, nor to maintain them in force. Should RAPISCAN choose to abandon an application once filed or decide not to pay any maintenance fee when due, RAPISCAN shall immediately grant title to such application or patent to the Government of the United States.

9.3 Inventions Made Solely by Government Employees and Joint Inventions. The FAA Technical Center, on behalf of the U.S. Government, shall have the initial option to retain title to each subject invention made solely by its employees and in each subject invention made jointly by RAPISCAN and Government employees. In the event that the FAA Technical Center informs RAPISCAN that it elects to retain title to such joint subject invention, RAPISCAN agrees to assign to the Government whatever right, title and interest RAPISCAN has in and to such joint subject invention.

9.4 Grant of Non-Exclusive License in U.S. Government Inventions.

The FAA Technical Center, on behalf of the U.S. Government, agrees to grant to RAPISCAN, for reasonable compensation not to exceed /*/ (as defined in Appendix
C), a nonexclusive license in any invention made under this AGREEMENT, in whole or in part, by a Government employee.

9.5 Exclusive License in U.S. Government Invention in Specific Field of Use.

The FAA Technical Center, on behalf of the U.S. Government, agrees to grant to RAPISCAN, for reasonable compensation, not to exceed /*/ (as defined in Appendix
C), exclusive license in any invention made under this AGREEMENT, in whole or in part, by a Government employee in the following specific field of use:

Automated Detection of Explosives in Baggage

9.6 Filing of Patent Application. The party having the right to retain title and file patent applications on a specific subject invention may elect not to file patent applications thereon provided it so advises the other party within sixty (60) days from the date it discloses the subject invention to the other party. Thereafter, the other party may elect to file patent applications on such subject invention and the party initially reporting such subject invention agrees to assign its right, title and interest in such subject invention to the other party and cooperate with such party in the preparation and filing of patent applications thereon. The assignment of the entire right, title, and interest to the other party pursuant to this paragraph shall be subject to the retention by the party assigning title of a non-exclusive, irrevocable, paid-up license to practice, or have practiced on its behalf, the subject invention throughout the world. In the event neither of the parties to this AGREEMENT elect to file a patent application on a subject invention, either or both (if a joint invention) may, at their sole discretion and subject to reasonable conditions, release the right to file to the inventor(s) with a license in each party of the same scope as set forth in the immediately preceding sentence.

9.7 Patent Expenses. The expenses attendant to the filing of patent applications as specified in 9.6 above, and all maintenance fees, shall be borne by the party filing the patent application. Any party having an obligation to pay a maintenance fee who decides not to pay such maintenance fee, shall so notify the other party of that decision in sufficient time to permit the other party to act to preserve its interest in the patent.

9.8 Prior Patents of RAPISCAN. RESERVED

/*/ Symbol indicates that material has been omitted pursuant to a request for confidential treatment and such material has been filed separately with the Securities and Exchange Commission.

9.9 Retention of Government Rights in Inventions Made Under this AGREEMENT.

9.9.1 Government License. RAPISCAN agrees to grant to the U.S. Government a nonexclusive, nontransferable, irrevocable, paid-up license to practice or have practiced throughout the world by or on behalf of the Government each invention made in whole or in part by its employees under this AGREEMENT. This license shall be evidenced by a confirmatory license agreement prepared by RAPISCAN in a form satisfactory to the FAA Technical Center.

9.9.2 March-in Rights. In the event the FAA Technical Center assigns title or grants an exclusive license to a subject invention made in whole or in part by a Government employee, the Government shall retain the right:

a) to require RAPISCAN to grant to a responsible applicant a nonexclusive, partially exclusive, or exclusive license to use the invention in the applicant's licensed field of use, on terms that are reasonable under the circumstances; or
b) if RAPISCAN fails to grant such a license, to grant the license itself. See 15 U.S.C. 3710a(b)(1)(B).

9.9.3 Government Exercise of March-in Rights. The Government may exercise its rights under Article 9.9.2 only in exceptional circumstances and only if the Government determines that

a) the action is necessary to meet health or safety needs that are not reasonably satisfied by the RAPISCAN;
b) the action is necessary to meet requirements for public use specified by Federal regulations, and such requirements are not reasonably satisfied by the RAPISCAN; or
c) the RAPISCAN has failed to comply with an agreement containing provisions described at 15 U.S.C. 3710a(c)(4)(B) pertaining to domestic manufacture of products embodying subject inventions. See 15 U.S.C. 371Oa(b)(1)(C) and Article 15.1.3 of this AGREEMENT.

ARTICLE 10. Copyrights

10.1 Ownership of Copyright. RAPISCAN shall have the option to own the copyright in all software (including modifications and enhancements thereto), documentation, and other works created in whole or in part by RAPISCAN under this AGREEMENT, which is subject to being copyrighted under Title 17, United States Code. RAPISCAN shall mark any such works with a copyright notice showing RAPISCAN as the author or co-author and shall in its reasonable discretion determine whether to file applications for registration of copyright. Should RAPISCAN choose not to own the copyright in any such software, it will execute an assignment of the copyright to the U.S. Government. The Government, as represented by the FAA Technical Center, agrees to license such software to RAPISCAN on terms acceptable to the parties.

10.2 Copyright Notice. RAPISCAN will clearly mark all copyrighted software or other works provided to the Government with appropriate notices.

ARTICLE 11. Copyright Royalties - RESERVED

ARTICLE 12. Proprietary Information

12.1 Ownership of Proprietary Information. Subject to Articles 9 and 10, any proprietary information developed solely by a party under this AGREEMENT shall be owned by the party which developed it. When proprietary information (except for computer software) is developed solely by RAPISCAN, RAPISCAN agrees to grant the U.S. Government a nonexclusive, royalty-free license to use, duplicate, and disclose in confidence, such proprietary information. Any jointly developed proprietary information shall be jointly owned by the FAA Technical Center and RAPISCAN. With respect to any such jointly owned proprietary information or proprietary information developed solely by the FAA Technical Center, RAPISCAN shall have the option to obtain from the U.S. Government an exclusive royalty- free license with respect to the Government's interest in the proprietary information, provided, however, that RAPISCAN shall exercise its option within twenty-four (24) months after termination or expiration of the AGREEMENT. This license is subject to reservation by the U.S. Government of a royalty-free right to use, duplicate, and disclose in confidence, the licensed proprietary information for Governmental purposes, and to permit others to do so on behalf of the U.S. Government and on behalf of any foreign Government or international organization pursuant to any existing or future treaty or agreement with the United States. The terms of any license respecting proprietary information developed solely by the FAA Technical Center shall be limited in accordance with 15 U.S.C. 3710a(c)(7)(B) dealing with exemptions to the Freedom of Information Act, 5 U.S.C. 552. Computer software developed solely by RAPISCAN is covered by Article 6.2 "Software."

12.2 Proprietary Notice. The parties will mutually develop an appropriate proprietary notice(s) for use in connection with this AGREEMENT. The parties agree to cooperate in removing or remarking any information marked as proprietary information which ceases to be proprietary information, for reasons set forth in Article 1.5 or because the information was publicly disclosed in a patent, copyrighted work, or as may be required by law.

ARTICLE 13. Expiration, Termination, Disputes and Extensions

13.1 Expiration and Termination. This AGREEMENT shall expire as specified in Article 5 unless both parties hereto agree in writing to extend it further. However, either party may terminate this AGREEMENT upon delivery of written notice at least ninety (90) days prior to such termination. Each party shall bear its own costs resulting from or related to the termination.

13.2 Disputes. RAPISCAN and the FAA Technical Center recognize that disputes arising under this AGREEMENT are best resolved at the local working level by the parties directly involved. Both parties are encouraged to be imaginative in designing mechanisms and

procedures to resolve disputes at this level. Any dispute arising under this AGREEMENT which is not disposed of by agreement of the parties shall be submitted jointly to the Administrator, Federal Aviation Administration, or his designee, for resolution. Subject to the rights, if any, of RAPISCAN to seek judicial relief, the decision of the Administrator, or his designee, shall be final.

13.3 Continuation of Cooperative Research Pending Resolution. Pending the resolution of any dispute under this Article, work under this AGREEMENT will continue as elsewhere provided herein.

13.4 Obligations Surviving Termination. Termination of this AGREEMENT by either party for any reason shall not affect the rights and obligations of the parties accrued prior to the effective date of termination of this AGREEMENT. No termination of this AGREEMENT, however effectuated, shall release the parties hereto from their rights, duties and obligations under Articles 3, 4, 6, 7, 8, 9, 10, 11, and 12.

13.5 Extensions. Extensions of the term of this AGREEMENT may be made prior to the expiration of the AGREEMENT without the need for additional review beyond that of the Director, FAA Technical Center, ACT-1. If the parties wish to continue the work called for under the OP after the expiration of this AGREEMENT, they may enter into a new CRDA.

ARTICLE 14. Independent Contractors

The parties to this AGREEMENT are independent contractors and are not agents of each other, joint venturers, partners or joint parties to a formal business organization of any kind. Neither party is authorized or empowered to act on behalf of the other with regard to any contract, warranty or representation as to any matter and neither party will be bound by the acts or conduct of the other. Each party will maintain sole and exclusive control over its own personnel and operations.

ARTICLE 15. Representations and Warranties

15.1 Representations and Warranties of the FAA Technical Center. The FAA Technical Center hereby represents and warrants to RAPISCAN as follows:

15.1.1 Mission. The performance of the activities specified by this AGREEMENT are consistent with the mission of the FAA Technical Center.

15.1.2 Authority. All prior reviews and approvals required by regulations or law have been obtained by the FAA Technical Center prior to the execution of the AGREEMENT. The FAA Technical Center official executing this AGREEMENT has the requisite authority to do so. Notwithstanding the delegation of authority to execute the AGREEMENT to the Director of the FAA Technical Center, ACT-1, the Administrator, Federal Aviation Administration, or his designee, pursuant to 15 U.S.C. 3710a(c)(5)(A), may disapprove or require the modification of this AGREEMENT within thirty (30) days of the date it is presented to him by the FAA Technical Center.

15.1.3 Statutory Compliance. The FAA Technical Center, prior to entering into this AGREEMENT, has (1) given special consideration to entering into CRDAs with small business firms and consortia involving small business firms; (2) has given preference to business units located in the United States which agree that products embodying inventions made under the AGREEMENT or produced through the use of such inventions will be manufactured substantially in the United States and; (3) in the event this AGREEMENT is made with an industrial organization or other person subject to the control of a foreign company or Government, taken into consideration whether or not such foreign Government permits United States agencies, organizations, or other persons to enter into CRDAs and licensing agreements with such foreign country.

15.2 Representations and Warranties of RAPISCAN. RAPISCAN hereby represents and warrants to the FAA Technical Center as follows:

15.2.1 Corporate Organization. RAPISCAN, as of the date hereof, is a corporation duly organized, validly existing and in good standing under the laws of the State of California.

15.2.2 Statement of Ownership. RAPISCAN is neither foreign controlled nor a subsidiary of a foreign controlled entity.

15.2.3 Power and Authority. RAPISCAN has the requisite power and authority to enter into this AGREEMENT and to perform according to the terms thereof.

15.2.4 Due Authorization. The Board of Directors and shareholders of RAPISCAN have taken all actions required to be taken by law, RAPISCAN's Certificate or Articles of Incorporation, its bylaws or otherwise, to authorize the execution and delivery of this AGREEMENT.

15.2.5 No Violation. The execution and delivery of this AGREEMENT does not contravene any material provision of, or constitute a material default under any material Agreement binding on RAPISCAN or any valid order of any court, or any regulatory agency or other body having authority to which RAPISCAN is subject.

ARTICLE 16. Liability

16.1 Tort Liability of Government. The U.S. Government shall not, except for gross negligence, fraud, abuse, or misuse, be responsible for any property of RAPISCAN consumed, damaged, or destroyed in the performance of this AGREEMENT. Any liability of the U.S. Government is determined pursuant to the Federal Tort Claims Act, 28 U.S.C. 2671 et seq.

16.2 Personal Injury and Damage to Property. RAPISCAN agrees to hold and save the Government, its officers, agents, and employees harmless from liability of any nature or kind, including costs and expenses, for, or on account of, any or all suits or damages of any character whatsoever resulting from injuries or damages sustained by any person or persons

or property by virtue of negligence on the part of RAPISCAN, its officers, agents, and employees in the performance of this AGREEMENT.

16.3 No Warranty. Except as specifically stated in Article 15, neither the FAA Technical Center nor RAPISCAN makes NO express or implied warranty as to any matter whatsoever, including the conditions of the research or any invention or product, whether tangible or intangible, made or developed under this agreement, or the ownership, MERCHANTABILITY, or fitness for a particular purpose of the research or any invention or product.

16.4 Indemnification. RAPISCAN holds the U.S. Government harmless and indemnifies the Government for all liabilities, demands, damages, expenses and losses arising out of the use by RAPISCAN, or any party acting on its behalf or under its authorization, of the FAA Technical Center's research and technical developments or out of any use, sale or other disposition by RAPISCAN, or others acting on its behalf or with its authorization, of products made by the use of the FAA Technical Center's technical developments. This provision shall survive termination of this AGREEMENT.

16.5 Disposal of Toxic or Other Waste. - RESERVED

ARTICLE 17. Force Majeure

Neither party shall be liable for any unforeseeable event beyond its reasonable control not caused by the fault or negligence of such party, which causes such party to be unable to perform its obligations under this AGREEMENT (and which it has been unable to overcome by the exercise of due diligence), including, but not limited to, flood, drought, earthquake, storm, fire, pestilence, lightning and other natural catastrophes, epidemic, war, riot, civic disturbance or disobedience, strikes, labor dispute, or failure, threat of failure, or sabotage, or any order or injunction made by a court or public agency other than an order or injunction made by or at the request of the FAA. In the event of the occurrence of such a force majeure event, the party unable to perform shall promptly notify the other party. It shall further use its best efforts to resume performance as quickly as possible and shall suspend performance only for such period of time as is necessary as a result of the force majeure event.

ARTICLE 18. Miscellaneous

18.1 No Benefits. No member of, or delegate to the United States Congress, or resident commissioner, shall be admitted to any share or part of this AGREEMENT, nor to any benefit that may arise therefrom; but this provision shall not be construed to extend to this AGREEMENT if made with a corporation for its general benefit.

18.2 Governing Law. The construction, validity, performance, and effect of this AGREEMENT for all purposes shall be governed by the laws applicable to the Government of the United States.

18.3 Entire Agreement. This AGREEMENT constitutes the entire agreement between the parties concerning the subject matter of this AGREEMENT.

18.4 Headings. Titles and headings of the Sections and Subsections of this AGREEMENT are for the convenience of references only and do not form a part of this AGREEMENT and shall in no way affect the interpretation thereof.

18.5 Waivers. None of the provisions of this AGREEMENT shall be considered waived by any party hereto unless such waiver is given in writing to all other parties. The failure of any party to insist upon strict performance of any of the terms and conditions hereof, or failure or delay to exercise any rights provided herein or by law, shall not be deemed a waiver of any rights of any party hereto.

18.6 Severability. The illegality or invalidity of any provisions of this AGREEMENT shall not impair, affect or invalidate the other provisions of this
AGREEMENT.

18.7 Amendments. If either party desires a modification in this AGREEMENT, the parties shall, upon reasonable notice of the proposed modification by the party desiring the change, confer in good faith to determine the desirability of such modification. Such modification shall not be effective until a written amendment is signed by the FAA and the chairman or president of RAPISCAN.

18.8 Assignment. Neither this AGREEMENT nor any rights or obligations of any party hereunder shall be assigned or otherwise transferred by either party without the prior written consent of the other party.

18.9 Export Controls. Information and/or products developed pursuant to this AGREEMENT may contain information for which export is restricted by the Arms Control Act (22 U.S.C. 2571 et seq.) or the Export Administration Act (50 U.S.C. 2401 et seq.). Nothing in this AGREEMENT shall be construed to permit any disclosure in violation of those restrictions.

ARTICLE 19. Notices

Notices, communications, and payments hereunder shall be deemed made if given by registered or certified envelope, postage prepaid, and addressed to the party to receive such notice, communication or payment at the address given below, or such other address as may hereafter be designated by notice in writing.

A. Formal notices under this AGREEMENT shall be addressed as follows:

```
     FAA Technical Center:
Name:       Jennelle Derrickson, AAR-201
Address:    Federal Aviation Administration
            William J. Hughes Technical Center
            Atlantic City International Airport
            New Jersey, 08405
Telephone:  609-485-5096

     RAPISCAN:

Name:       Andreas F. Kotowski
Address:    2830 Temple Avenue
            Long Beach, California 90806
Telephone:  562-427-0515

cc:
Name:       Allan B. Duboff, Esq.
            Richman, Lawrence, Mann, Chizever & Phillips
Address:    9601 Wilshire Boulevard
            Penthouse
            Beverly Hills, California 90210
Telephone:  310-274-8300
```

B. Correspondence relating to technical matters should be addressed as follows:

```
     FAA Technical Center:
Name:       Jennelle Derrickson, AAR-201
Address:    Federal Aviation Administration
            William J. Hughes Technical Center
            Atlantic City International Airport
            New Jersey, 08405
Telephone:  609-485-5096

     AAR-520:

Name:       Roy Mason, AAR-520
Address:    FAA Technical Center
            Atlantic City International Airport
            Atlantic City, NJ 08405
Telephone:  609-485-4153
```

```
     RAPISCAN:
Name:       Peter Modica
Address:    2830 Temple Avenue
            Long Beach, California 90806
Telephone:  562-427-0515

cc:
Name:       Andreas F. Kotowski
Address:    2830 Temple Avenue
            Long Beach, California 90806
Telephone:  562-427-0515
```

ARTICLE 20. Review and Ratification

20.1 Review of CRDA by ARA-1. One copy of this document must be presented to the Associate Administrator for Research and Acquisitions, ARA-1, Federal Aviation Administration, for review. Receipt of this document by ARA-1 will begin a thirty (30) day period during which the AGREEMENT may be disapproved or modification required. If no notice of disapproval or required modification is received from the ARA-1 during the review period, this AGREEMENT shall enter into effect as of the date of the signature of the Director of the FAA Technical Center, ACT-1.

20.2 Ratification by RAPISCAN. In the event that the Associate Administrator for Research and Acquisitions, ARA-1, Federal Aviation Administration, exercises the authority reserved by Article 15.1.2, RAPISCAN shall have thirty (30) days from notification of the required modifications to ratify the modifications or terminate the AGREEMENT.

20.3 Certification. This AGREEMENT has been received by the Aviation Security Research & Development Division of the Federal Aviation Administration, AAR-500. The effort called for under this AGREEMENT is consistent with the mission of the FAA Technical Center and the participation by the Technical Center in this AGREEMENT is endorsed and supported by the Manager of the Aviation Security Research & Development Division, AAR-500.

/s/ Paul A. Polski

Paul A. Polski, Division Manager
Aviation Security Research & Development Division, AAR-500

DATE: 3/13/98

IN WITNESS THEREOF, the Parties have caused this AGREEMENT to be executed in duplicate by their duly authorized representatives as follows:

RAPISCAN SECURITY PRODUCTS, INC.

BY /s/ Andreas F. Kotowski

NAME: Andreas F. Kotowski

TITLE: President

DATE:

FAA WILLIAM J. HUGHES TECHNICAL CENTER

BY: /s/ Anne Harlan

NAME: Anne Harlan

TITLE: Director

DATE: 5/13/98

APPENDIX A

COOPERATIVE RESEARCH AND DEVELOPMENT AGREEMENT
FAA TECHNICAL CENTER/RAPISCAN

OBLIGATION OF THE PARTIES

1.0 STATEMENT OF WORK

BACKGROUND

The development of effective enhanced automated baggage screening systems is a continuing effort at the Federal Aviation Administration (FAA) Technical Center. The Aviation Security Research & Development Division has been examining the potential of several technologies and is particularly interested in further development of the X-ray measurement and analysis techniques currently under development by Rapiscan. The Rapiscan technology is unique and proprietary in its particular scanning approach as well as in its image processing ability to sort out the signatures of numerous objects within a typical piece of luggage and then to identify to an operator whether a particular object constitutes a threat (explosive). The technology has been developed to the point where it is approaching the capability to meet the detection and throughput requirements for enhanced automated inspection of luggage at an airport.

OBJECTIVE AND PLAN

The intent of this CRDA is to assist Rapiscan to optimize its prototype enhanced automated X-ray baggage screening system for use at airports.

EXPECTED RESULTS

As a result of this agreement, we anticipate that there will be progress toward developing enhanced automated baggage screening systems that can more effectively screen carry-on and checked passenger luggage at airports.

CONSTRAINTS

All information concerning system performance generated under this agreement will be covered by the Classification Guide for FAA Explosives Detection Systems Information and Data. No classified information shall be generated or received by Rapiscan unless site and personnel clearances are granted by the Defense Investigative Service. Participation in testing shall be restricted to those personnel having the need to know and possessing the appropriate security clearance. However, participation of Rapiscan personnel is considered essential. FAA will attempt to conduct the tests in a fashion that will allow the widest possible participation by Rapiscan personnel and consultants without comprising classified

information. Rapiscan will supply cleared personnel to participate in the testing whenever possible.

All explosive materials used during testing shall be handled by trained personnel. FAA will have the responsibility for providing the explosives test articles. Storage, handling, and transportation shall be in compliance with established safety procedures and shall be in compliance with local, state, FAA, and Federal regulations.

All reports generated resulting from work covered by this CRDA shall be consistent with both security procedures and non-disclosure agreements and are releasable only with the approval of FAA and the Rapiscan technical contact.

2.0 OBLIGATIONS OF THE PARTIES

2.1 Obligations of the FAA Technical Center

FAA shall provide assistance in several areas of development. These include:
collaboration with FAA scientists, engineers, consultants, and testing personnel; use of laboratory facilities, including assistance in obtaining test samples of explosives, detonators, and luggage; and coordination with airports and Government agencies to facilitate obtaining performance data. FAA will provide test samples that include typical explosives in quantities used by terrorists against civil aviation. FAA will supply both clean actual passenger bags and bags with explosives concealed in a manner consistent with known terrorist threats. FAA will test for Probability of Detection and False Alarm rate as a function of weight and type of explosive. The threat objects may be either bulk or sheet explosives. Additional threat objects may be added to characterize system performance. FAA will provide to Rapiscan information consistent with security regulations so that system performance can be optimized.

2.2 Obligations of Rapiscan:

Under this agreement, Rapiscan shall furnish to the FAA one or more of its prototype X-ray machines for testing and data collection at the Technical Center or at appropriate sites, for times and duration that are mutually acceptable. Rapiscan will provide to FAA information regarding system operation, system design, and algorithm development. Any information that is company proprietary shall be so labeled and will be treated accordingly. If testing of the Rapiscan X-ray system is to be done either at the FAA Technical Center or at Los Angeles Airport, Rapiscan will make the arrangements and pay for the shipping. At sites other than the above, the arrangements and cost of shipping will be negotiated between Rapiscan and FAA.

APPENDIX B
QUARTERLY PROGRESS REPORT (PAGE 1)

```
CRDA #:  97-A-0106     Quarterly Report #                Date:
       --------------                     -------------       -----------------

Subject: X-Ray and Computer Automation
         ----------------------------

PI: Roy Mason
    ---------

Route Symbol: AAR-520                 Phone: 609-485-4153
              -------                        ------------

Initiation Date:                      Term: 36 months
                -------------               ---------
```

Collaborator (CRO): Rapiscan Security Products, Inc.

STATUS:
(Brief narrative)

Check appropriate box:
[_] Will complete on time
[_] Will require more time (only)
[_] Will require more time and minor change in Obligations of the Parties
[_] Will require major change in Scope of Work
[_] Will complete on time and extend activities under a new CRDA
[_] Other:_____

QUARTERLY PROGRESS REPORT (PAGE 2)

Please provide supplementary cost data for the FAA that reflect any changes from the original cost estimate you submitted to the TTPO.

SUPPLEMENTARY COST DATA: FAA

CATEGORY		DATA
1. PERSONNEL		
A. Number of people		____
B. Person hours (total)		____
C. Cost/hour		____
B x C = dollars	(1)	____
2. FACILITIES		
A. Storage		
1. Days used		____
2. Cost/day		____
B. Facilities usage		
1. Hours used		____
2. Cost/hour		____
A.1 x A.2 = dollars	(2)	____
B.1 x B.2 = dollars	(3)	____
3. EQUIPMENT/SUPPLIES		
A. Existing equipment		
1. Hours used		____
2. Cost/hour		____
A.1 x A.2 = dollars	(4)	____
B. Newly purchased for this CRDA (total dollars)	(5)	____
TOTAL VALUE OF CRDA (1 + 2 + 3 + 4 + 5)		____

QUARTERLY PROGRESS REPORT (PAGE 3)

Please provide supplementary cost data for the FAA that reflect any changes from the original cost estimates you submitted to the TTPO.

SUPPLEMENTARY COST DATA: CRO (COLLABORATOR)

CATEGORY		DATA
1. PERSONNEL		
A. Number of people		____
B. Person hours (total)		____
C. Cost/hour		____
B x C = dollars	(1)	____
2. FACILITIES		
A. Storage		
1. Days used		____
2. Cost/hour		____
B. Facilities usage		
1. Hours used		____
2. Cost/hour		____
A.1 x A.2 = dollars	(2)	____
B.1 x B.2 = dollars	(3)	____
3. EQUIPMENT/SUPPLIES		
A. Existing equipment		
1. Hours used		____
2. Cost/hour		____
A.1 x A.2 = dollars	(4)	____
B. Newly purchased for this CRDA (total dollars)	(5)	____
4. FUNDS (OTHER DOLLARS EXPENDED FOR THIS CRDA)	(6)	____
TOTAL VALUE OF CRDA (1 + 2 + 3 + 4 + 5 + 6)		____

FINAL REPORT (PAGE 1)

CRDA # 97-A-0106 Date: 1/27/97

Subject: X-Ray and Computer Automation

PI: Roy Mason

Route Symbol: AAR-520 Phone: 609-485-4153

Initiation Date: Term: 36 MONTHS

Collaborator (CRO): Rapiscan Security Products, Inc.

Prepare a brief narrative report discussing the highlights of the project. Address the following topics (use additional pages if necessary).

SUCCESSES (How the project met or exceeded its objectives):

SHORTCOMINGS (Disappointments, limitations, shortfalls):

CONTINUING ACTIVITIES (Follow-on work; other research; additional agreements):

TECHNOLOGY TRANSFER APPLICATIONS (Commercial applications, markets, etc.):

FINAL REPORT (PAGE 2)

Please provide supplementary cost data for the FAA that reflect any changes from the original cost estimates you submitted to the TTPO.

SUPPLEMENTARY COST DATA: FAA

CATEGORY		DATA
1. PERSONNEL		
A. Number of people		____
B. Person hours (total)		____
C. Cost/hour		____
B x C = dollars	(1)	____
2. FACILITIES		
A. Storage		
1. Days used		____
2. Cost/hour		____
B. Facilities usage		
1. Hours used		____
2. Cost/hour		____
A.1 x A.2 = dollars	(2)	____
B.1 x B.2 = dollars	(3)	____
3. EQUIPMENT/SUPPLIES		
A. Existing equipment		
1. Hours used		____
2. Cost/hour		____
A.1 x A.2 = dollars	(4)	____
B. Newly purchased for this CRDA (total dollars)	(5)	____
TOTAL VALUE OF CRDA (1 + 2 + 3 + 4 + 5)		____

FINAL REPORT (PAGE 3)

Please provide supplementary cost data for the FAA that reflect any changes from the original cost estimates you submitted to the TTPO.

SUPPLEMENTARY COST DATA: CRO (COLLABORATOR)

CATEGORY		DATA
1. PERSONNEL		
A. Number of people		____
B. Person hours (total)		____
C. Cost/hour		____
B x C = dollars	(1)	____
2. FACILITIES		
A. Storage		
1. Days used		____
2. Cost/hour		____
B. Facilities usage		
1. Hours used		____
2. Cost/hour		____
A.1 x A.2 = dollars	(2)	____
B.1 x B.2 = dollars	(3)	____
3. EQUIPMENT/SUPPLIES		
A. Existing equipment		
1. Hours used		____
2. Cost/hour		____
A.1 x A.2 = dollars	(4)	____
B. Newly purchased for this CRDA (total dollars)	(5)	____
4. FUNDS (OTHER DOLLARS EXPENDED FOR THIS CRDA)	(6)	____
TOTAL VALUE OF CRDA (1 + 2 + 3 + 4 + 5 + 6)		____

APPENDIX C

DEFINITIONS FOR CALCULATING THE ROYALTY RATES MENTIONED IN SECTION 9.4 AND SECTION 9.5:

(a) "Component Products" shall mean Products which are incorporated in, or a component of, another item or device.

(b) /*/

(c) "Products" shall mean items or devices that include and rely on licensed technology and any elements or applications thereof that are incorporated therein, or components or intermediate structures thereof.

/*/ Symbol indicates that material has been omitted pursuant to a request for confidential treatment and such material has been filed separately with the Securities and Exchange Commission.

ARTICLE 5

MULTIPLIER: 1,000

PERIOD TYPE	3 MOS
FISCAL YEAR END	JUN 30 1999
PERIOD START	JUL 01 1998
PERIOD END	SEP 30 1998
CASH	17,498
SECURITIES	1,598
RECEIVABLES	23,736
ALLOWANCES	0
INVENTORY	25,888
CURRENT ASSETS	73,884
PP&E	12,983
DEPRECIATION	0
TOTAL ASSETS	96,492
CURRENT LIABILITIES	27,747
BONDS	166
PREFERRED MANDATORY	0
PREFERRED	0
COMMON	49,140
OTHER SE	19,143
TOTAL LIABILITY AND EQUITY	96,492
SALES	21,404
TOTAL REVENUES	21,404
CGS	14,988
TOTAL COSTS	14,988
OTHER EXPENSES	4,413
LOSS PROVISION	0
INTEREST EXPENSE	(167)
INCOME PRETAX	2,170
INCOME TAX	510
INCOME CONTINUING	1,660
DISCONTINUED	0
EXTRAORDINARY	0
CHANGES	0
NET INCOME	1,660
EPS PRIMARY	0.17
EPS DILUTED	0.17

End of Filing

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