

# OSI SYSTEMS INC

## FORM 10-Q (Quarterly Report)

Filed 05/09/13 for the Period Ending 03/31/13

Address	12525 CHADRON AVE HAWTHORNE, CA 90250
Telephone	3109780516
CIK	0001039065
Symbol	OSIS
SIC Code	3674 - Semiconductors and Related Devices
Industry	Scientific & Technical Instr.
Sector	Technology
Fiscal Year	06/30

---

---

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

---

**FORM 10-Q**

---

(Mark One)

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

For the quarterly period ended March 31, 2013

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 000-23125

---

**OSI SYSTEMS, INC.**

(Exact name of registrant as specified in its charter)

---

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**33-0238801**  
(I.R.S. Employer  
Identification No.)

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

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

N/A  
(Former name, former address and former fiscal year, if changed since last report)

---

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 that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of May 7, 2013, there were 19,937,443 shares of the registrant's common stock outstanding.

---

---

---

## OSI SYSTEMS, INC.

## INDEX

	<u>PAGE</u>
<b>PART I — FINANCIAL INFORMATION</b>	<b>3</b>
Item 1 — Condensed Consolidated Financial Statements	3
Condensed Consolidated Balance Sheets at June 30, 2012 and March 31, 2013	3
Condensed Consolidated Statements of Operations for the three and nine months ended March 31, 2012 and 2013	4
Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended March 31, 2012 and 2013	5
Condensed Consolidated Statements of Cash Flows for the nine months ended March 31, 2012 and 2013	6
Notes to Condensed Consolidated Financial Statements	7
Item 2 — Management’s Discussion and Analysis of Financial Condition and Results of Operations	15
Item 3 — Quantitative and Qualitative Disclosures about Market Risk	21
Item 4 — Controls and Procedures	22
<b>PART II — OTHER INFORMATION</b>	<b>22</b>
Item 1 — Legal Proceedings	22
Item 1A — Risk Factors	23
Item 2 — Unregistered Sales of Equity Securities and Use of Proceeds	35
Item 3 — Defaults Upon Senior Securities	35
Item 4 — Mine Safety Disclosures	35
Item 5 — Other Information	35
Item 6 — Exhibits	35
Signatures	36

## PART I. FINANCIAL INFORMATION

## Item 1. Condensed Consolidated Financial Statements

## OSI SYSTEMS, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts)

(Unaudited)

	June 30, 2012	March 31, 2013
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 91,452	\$ 47,680
Accounts receivable, net of allowance for doubtful accounts of \$5,054 and \$6,443 as of June 30, 2012 and March 31, 2013, respectively	156,867	169,418
Inventories	195,178	198,292
Deferred income taxes	19,205	19,026
Prepaid expenses and other current assets	20,411	37,737
Total current assets	483,113	472,153
Property and equipment, net	111,664	238,815
Goodwill	82,149	83,646
Intangible assets, net	37,742	37,276
Other assets	35,228	23,712
Total assets	\$ 749,896	\$ 855,602
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Bank lines of credit	\$ —	\$ 55,000
Current portion of long term debt	215	1,795
Accounts payable	56,422	81,817
Accrued payroll and employee benefits	24,749	25,770
Advances from customers	22,677	32,444
Accrued warranties	17,562	13,963
Deferred revenue	20,194	16,748
Other accrued expenses and current liabilities	18,830	28,157
Total current liabilities	160,649	255,694
Long-term debt	2,467	11,099
Advances from customers	100,000	81,250
Other long-term liabilities	52,661	48,858
Total liabilities	315,777	396,901
Commitments and contingencies (Note 7)		
Stockholders' Equity:		
Preferred stock, \$0.001 par value—authorized, 10,000,000 shares; no shares issued or outstanding	—	—
Common stock, \$0.001 par value—authorized, 100,000,000 shares; issued and outstanding, 19,821,064 at June 30, 2012 and 19,933,626 shares at March 31, 2013	282,756	278,109
Retained earnings	155,651	187,940
Accumulated other comprehensive loss	(4,288)	(7,348)
Total stockholders' equity	434,119	458,701
Total liabilities and stockholders' equity	\$ 749,896	\$ 855,602

See accompanying notes to condensed consolidated financial statements.

**OSI SYSTEMS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share amounts)

(Unaudited)

	For the Three Months Ended March 31,		For the Nine Months Ended March 31,	
	2012	2013	2012	2013
Net revenues:				
Products	\$ 180,306	\$ 139,026	\$ 475,103	\$ 432,976
Services	28,133	59,383	82,646	141,176
Total net revenues	208,439	198,409	557,749	574,152
Cost of goods sold:				
Products	119,574	96,156	312,654	288,988
Services	19,734	30,415	57,283	81,883
Total cost of goods sold	139,308	126,571	369,937	370,871
Gross profit	69,131	71,838	187,812	203,281
Operating expenses:				
Selling, general and administrative	37,063	37,752	107,409	114,506
Research and development	12,932	12,386	35,358	35,560
Impairment, restructuring and other charges	931	2,286	931	5,009
Total operating expenses	50,926	52,424	143,698	155,075
Income from operations	18,205	19,414	44,114	48,206
Interest expense and other income, net	(792)	(1,341)	(2,312)	(3,823)
Income before income taxes	17,413	18,073	41,802	44,383
Provision for income taxes	4,838	4,544	12,165	12,094
Net income	<u>\$ 12,575</u>	<u>\$ 13,529</u>	<u>\$ 29,637</u>	<u>\$ 32,289</u>
Net income per share:				
Basic	<u>\$ 0.63</u>	<u>\$ 0.68</u>	<u>\$ 1.51</u>	<u>\$ 1.62</u>
Diluted	<u>\$ 0.62</u>	<u>\$ 0.66</u>	<u>\$ 1.46</u>	<u>\$ 1.57</u>
Shares used in per share calculation:				
Basic	<u>19,815</u>	<u>19,987</u>	<u>19,692</u>	<u>19,964</u>
Diluted	<u>20,433</u>	<u>20,555</u>	<u>20,253</u>	<u>20,578</u>

See accompanying notes to condensed consolidated financial statements.

OSI SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(amounts in thousands)

(Unaudited)

	For the Three Months Ended March 31,		For the Nine Months Ended March 31,	
	2012	2013	2012	2013
Net income	\$ 12,575	\$ 13,529	\$ 29,637	\$ 32,289
Other comprehensive income (loss):				
Foreign currency translation adjustment	2,863	(7,709)	(2,529)	(2,970)
Other	205	250	214	(89)
Other comprehensive income (loss)	3,068	(7,459)	(2,315)	(3,059)
Comprehensive income	\$ 15,643	\$ 6,070	\$ 27,322	\$ 29,230

See accompanying notes to condensed consolidated financial statements.

## OSI SYSTEMS, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(amounts in thousands)

(Unaudited)

	For the Nine Months Ended March 31,	
	2012	2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 29,637	\$ 32,289
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,899	17,872
Stock based compensation expense	5,345	11,482
Provision for losses on accounts receivable	52	2,508
Equity in (earnings) loss of unconsolidated affiliates	(155)	51
Deferred income taxes	(40)	196
Other	47	187
Changes in operating assets and liabilities —net of business acquisitions :		
Accounts receivable	(20,948)	(15,181)
Inventories	(33,468)	(4,745)
Prepaid expenses and other current assets	(3,946)	14,819
Accounts payable	(2,976)	25,283
Accrued payroll and related expenses	(2,052)	1,035
Advances from customers	98,853	(9,382)
Accrued warranties	1,659	(3,538)
Deferred revenue	(20)	(5,471)
Other accrued expenses and current liabilities	(705)	(10,158)
Net cash provided by operating activities	86,182	57,247
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Acquisition of property and equipment	(44,199)	(139,429)
Acquisition of businesses, net of cash acquired	(3,189)	(6,087)
Acquisition of intangible and other assets	(3,085)	(3,773)
Net cash used in investing activities	(50,473)	(149,289)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net borrowings of bank lines of credit	—	55,000
Proceeds from long-term debt	—	11,100
Payments on long-term debt	(163)	(824)
Proceeds from exercise of stock options and employee stock purchase plan	4,796	4,615
Repurchase of common shares	(1,344)	(10,444)
Taxes paid related to net share settlements of equity awards	(2,320)	(10,301)
Net cash provided by financing activities	969	49,146
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>	(1,510)	(876)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	35,168	(43,772)
<b>CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD</b>	55,619	91,452
<b>CASH AND CASH EQUIVALENTS - END OF PERIOD</b>	\$ 90,787	\$ 47,680
Supplemental disclosure of cash flow information:		
Interest paid	\$ 2,184	\$ 2,256
Income taxes paid	\$ 5,460	\$ 9,679

See accompanying notes to condensed consolidated financial statements.

OSI SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**1. Basis of Presentation**

*Description of Business*

OSI Systems, Inc., together with its subsidiaries (the “Company”), is a vertically integrated designer and manufacturer of specialized electronic systems and components for critical applications, and a provider of security screening services. The Company sells its products and services in diversified markets, including homeland security, healthcare, defense and aerospace.

The Company has three operating divisions: (i) Security, providing security and inspection systems, turnkey security screening solutions and related services; (ii) Healthcare, providing patient monitoring, diagnostic cardiology and anesthesia systems, and related services; and (iii) Optoelectronics and Manufacturing, providing specialized electronic components and electronic manufacturing services for the Security and Healthcare divisions, as well as to external original equipment manufacturer clients for applications in the defense, aerospace, medical and industrial markets, among others.

Through its Security division, the Company designs, manufactures, markets, and services security and inspection systems globally, and provides turnkey security screening solutions. The Security division’s products are used to inspect baggage, cargo, vehicles and other objects for weapons, explosives, drugs and other contraband, and to screen people. These products and services are also used for the safe, accurate and efficient verification of cargo manifests for the purpose of assessing duties and monitoring the export and import of controlled materials.

Through its Healthcare division, the Company designs, manufactures, markets and services patient monitoring, diagnostic cardiology and anesthesia delivery and ventilation systems globally. These products are used by care providers in critical care, emergency and perioperative areas within hospitals as well as physicians’ offices, medical clinics and ambulatory surgery centers.

Through its Optoelectronics and Manufacturing division, the Company designs, manufactures and markets optoelectronic devices and provides electronics manufacturing services globally for use in a broad range of applications, including aerospace and defense electronics, security and inspection systems, medical imaging and diagnostic products, telecommunications, test and measurement devices, industrial automation systems, automotive diagnostic products and renewable energy technologies. This division provides products and services to original equipment manufacturers and end users as well as to the Company’s own Security and Healthcare divisions.

*Basis of Presentation*

The unaudited condensed consolidated financial statements include the accounts of OSI Systems, Inc. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. These condensed consolidated financial statements have been prepared by the Company, without audit, pursuant to interim financial reporting guidelines and the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of the Company’s management, the unaudited condensed consolidated financial statements include all adjustments, consisting of only normal and recurring adjustments, necessary for a fair presentation of the financial position and the results of operations as of the dates and for the periods presented. These unaudited quarterly condensed consolidated financial statements and the accompanying notes should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2012 filed with the Securities and Exchange Commission on August 13, 2012. The results of operations for the three and nine months ended March 31, 2013 are not necessarily indicative of the operating results to be expected for the full fiscal year or any future periods.

*Per Share Computations*

The Company computes basic earnings per share by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. The Company computes diluted earnings per share by dividing net income available to common stockholders by the sum of the weighted average number of common and dilutive potential common shares

## Table of Contents

outstanding. Potential common shares consist of the shares issuable upon the exercise of stock options under the treasury stock method. There were no shares excluded from the calculation of diluted earnings per share for the three months and nine month periods ended March 31, 2013.

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2013	2012	2013
Net income available to common stockholders	\$ 12,575	\$ 13,529	\$ 29,637	\$ 32,289
Weighted average shares outstanding — basic	19,815	19,987	19,692	19,964
Dilutive common equivalent shares from stock options and restricted stock awards	618	568	561	614
Weighted average shares outstanding — diluted	20,433	20,555	20,253	20,578
Basic net income per share	\$ 0.63	\$ 0.68	\$ 1.51	\$ 1.62
Diluted net income per share	\$ 0.62	\$ 0.66	\$ 1.46	\$ 1.57

### Cash Equivalents

The Company considers all highly liquid investments purchased with maturities of approximately three months or less as of the acquisition date to be cash equivalents.

Components of cash and cash equivalents consisted of:

	June 30, 2012	March 31, 2013
Cash in bank	\$ 47,402	\$ 47,569
Money market	34,063	111
Commercial paper	9,987	—
Total	\$ 91,452	\$ 47,680

### Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash, marketable securities, derivative instruments, accounts receivable, accounts payable and debt instruments. The carrying values of financial instruments, other than debt instruments, are representative of their fair values due to their short-term maturities. The carrying values of the Company's long-term debt instruments are considered to approximate their fair values because the interest rates of these instruments are variable or comparable to current interest rates available to the Company.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company has determined that all of its marketable securities fall into the "Level 1" category, which values assets and liabilities at the quoted prices in active markets for identical assets and liabilities; while the Company's derivative instruments fall into the "Level 2" category, which values assets and liabilities from observable inputs other than quoted market prices. There were no assets or liabilities where "Level 3" valuation techniques were used, and there were no assets and liabilities measured at fair value on a non-recurring basis.

The fair values of the Company's assets (liabilities) were:

	June 30, 2012	March 31, 2013
Level 1	\$ 10,955	\$ 13,879
Level 2	13	60
Total	\$ 10,968	\$ 13,940

*Derivative Instruments and Hedging Activity*

The Company's use of derivatives consists primarily of foreign exchange contracts and interest rate swap agreements. As of March 31, 2013, the Company had outstanding foreign currency forward contracts of approximately \$22.6 million. The foreign exchange contracts do not meet the criteria as effective cash flow hedges. Therefore, the net gain (loss) from these contracts is reported in Interest expense and other income, net in the condensed consolidated statement of operations. An interest rate swap agreement was entered into to improve the predictability of cash flows from interest payments related to a mortgage loan with variable, LIBOR-based debt.

The interest rate swap matures in October 2019. It is considered an effective cash flow hedge, and, as a result, the net gains or losses on such instrument were reported as a component of other comprehensive income in the condensed consolidated financial statements and are reclassified as net earnings when the hedge transaction settles.

*Revenue Recognition*

The Company recognizes revenue from sales of products upon shipment when title and risk of loss passes, and when terms are fixed and collection is probable. Revenue from services includes after-market services, installation and implementation of products, and turnkey security screening services. The portion of revenue for the sale attributable to installation is deferred and recognized when the installation service is provided. In an instance where terms of sale include subjective customer acceptance criteria, revenue is deferred until the Company has achieved the acceptance criteria. Concurrent with the shipment of the product, the Company accrues estimated product return reserves and warranty expenses. Critical judgments made by management related to revenue recognition include the determination of whether or not customer acceptance criteria are perfunctory or inconsequential. The determination of whether or not customer acceptance terms are perfunctory or inconsequential impacts the amount and timing of revenue recognized. Critical judgments also include estimates of warranty reserves, which are established based on historical experience and knowledge of the product under warranty.

Revenue from certain fixed-fee turnkey services agreements is recognized based upon proportional performance, measured by the actual number of hours incurred divided by the total estimated number of hours for the project. The impact of changes in the estimated hours to service the agreement is reflected in the period during which the change becomes known.

Revenues from out-of-warranty service maintenance contracts are recognized ratably over the term of such contract. For services not derived from specific maintenance contracts, revenues are recognized as the services are performed. Deferred revenue for such services arises from payments received from customers for services not yet performed.

*Business Combinations*

During the normal course of business the Company makes acquisitions. In the event that an individual acquisition (or an aggregate of acquisitions) is material, appropriate disclosure of such acquisition activity is disclosed.

**2. Balance Sheet Details**

The following tables provide details of selected balance sheet accounts (in thousands):

	June 30, 2012	March 31, 2013
<b>Inventories, net</b>		
Raw materials	\$ 103,747	\$ 114,431
Work-in-process	28,096	30,664
Finished goods	63,335	53,197
Total	<u>\$ 195,178</u>	<u>\$ 198,292</u>

	June 30, 2012	March 31, 2013
<b>Property and equipment</b>		
Land	\$ 5,193	\$ 8,329
Buildings and improvements	13,597	76,636
Leasehold improvements	12,385	9,528
Equipment and tooling	74,789	134,165
Furniture and fixtures	3,982	4,510
Computer equipment	13,937	17,535
Software	15,245	16,098
Construction in process	52,269	59,211
Total	191,397	326,012
Less: accumulated depreciation and amortization	(79,733)	(87,197)
Property and equipment, net	<u>\$ 111,664</u>	<u>\$ 238,815</u>

Construction in process consists primarily of costs related to infrastructure in Mexico.

### 3. Goodwill and Intangible Assets

The changes in the carrying value of goodwill for the nine month period ended March 31, 2013, are as follows (in thousands):

	Security	Healthcare	Optoelectronics and Manufacturing	Consolidated
Balance as of June 30, 2012	\$ 27,583	\$ 35,887	\$ 18,679	\$ 82,149
Goodwill acquired or adjusted during the period	798	—	701	1,499
Foreign currency translation adjustment	98	(94)	(6)	(2)
Balance as of March 31, 2013	<u>\$ 28,479</u>	<u>\$ 35,793</u>	<u>\$ 19,374</u>	<u>\$ 83,646</u>

Intangible assets consisted of the following (in thousands):

	Weighted Average Lives	June 30, 2012			March 31, 2013		
		Gross Carrying Value	Accumulated Amortization	Intangibles Net	Gross Carrying Value	Accumulated Amortization	Intangibles Net
<b>Amortizable assets:</b>							
Software development costs	5 years	\$ 15,175	\$ 4,140	\$ 11,035	\$ 16,695	\$ 4,879	\$ 11,816
Patents	16 years	4,259	526	3,733	5,352	603	4,749
Core technology	10 years	2,093	1,548	545	2,038	1,660	378
Developed technology	12 years	20,022	12,560	7,462	19,990	14,097	5,893
Customer relationships/backlog	8 years	11,955	7,611	4,344	9,178	5,334	3,844
Total amortizable assets		53,504	26,385	27,119	53,253	26,573	26,680
<b>Non-amortizable assets -</b>							
Trademarks		10,623	—	10,623	10,596	—	10,596
Total intangible assets		<u>\$ 64,127</u>	<u>\$ 26,385</u>	<u>\$ 37,742</u>	<u>\$ 63,849</u>	<u>\$ 26,573</u>	<u>\$ 37,276</u>

Amortization expense related to intangibles assets was \$3.4 million and \$3.5 million for the nine months ended March 31, 2012 and 2013, respectively. For the three months ended March 31, 2012 and 2013, amortization expense was \$1.1 million and \$1.2 million, respectively. At March 31, 2013, the estimated future amortization expense was as follows (in thousands):

2013 (remaining 3 months)	\$ 1,422
2014	4,617
2015	1,636
2016	1,380
2017	1,133
2018	1,108
2019 and thereafter	15,384
Total	<u>\$ 26,680</u>

#### 4. Borrowings

The Company has a \$425 million credit agreement maturing November 2016. The credit agreement consists of a \$425 million revolving credit facility, including a \$375 million sub-limit for letters of credit. The Company has the ability to increase the facility by \$100 million under certain circumstances. Borrowings under this facility bear interest at the London Interbank Offered Rate (LIBOR) plus a margin of 1.5% as of March 31, 2013. This margin is determined by the Company's consolidated leverage ratio and may range from 1.5% to 2.0%. Letters of credit reduce the amount available to borrow by their face value. The unused portion of the facility bears a commitment fee of 0.25%. The Company's borrowings under the credit agreement are guaranteed by the Company's U.S. based subsidiaries and are secured by substantially all of the Company's and certain subsidiaries' assets. The agreement contains various representations, warranties, affirmative, negative and financial covenants, and conditions of default customary for financing agreements of this type. As of March 31, 2013, \$55 million was outstanding under the revolving credit facility and letters-of-credit outstanding totaled \$185.6 million.

Several of the Company's foreign subsidiaries maintain bank lines-of-credit, denominated in local currencies, to meet short-term working capital requirements and for the issuance of letters-of-credit. As of March 31, 2013, \$6.3 million was outstanding under these letter-of-credit facilities, while no debt was outstanding. As of March 31, 2013, the total amount available under these credit facilities was \$35.6 million, with a total cash borrowing sub-limit of \$4.1 million.

In September 2012, the Company entered into a term loan agreement for \$11.1 million to fund the acquisition of land and a building in the state of Washington. The loan is payable over seven years and bears interest at LIBOR plus 1.25%, which is payable on a monthly basis. Concurrent with entering into the floating rate loan, the Company entered into an interest rate swap agreement that effectively locks the interest rate of the loan to 2.2% per annum for the term of the loan. As of March 31, 2013, \$10.4 million remained outstanding under this loan.

Long-term debt consisted of the following (in thousands):

	June 30, 2012	March 31, 2013
Term loans	\$ 2,682	\$ 12,894
Less current portion of long-term debt	215	1,795
Long-term portion of debt	<u>\$ 2,467</u>	<u>\$ 11,099</u>

#### 5. Stock-based Compensation

The Company maintains two share-based employee compensation plans: the 2012 Incentive Award Plan (2012 Plan) and the 2006 Equity Incentive Plan (2006 Plan). In September 2012, the Company's board of directors approved the 2012 Plan, and in December 2012 the stockholders adopted the 2012 Plan, effective on December 12, 2012, which serves as the successor to the 2006 Plan and provides for the issuance of incentive and non-statutory stock options, restricted stock awards, stock appreciation rights, restricted stock units (RSUs), performance shares and stock bonuses to qualified employees, directors and consultants, amongst other forms of equity. No new awards will be issued under the 2006 Plan as of the effective date of the 2012 Plan. Outstanding awards under the 2006 Plan continue to be subject to the terms and conditions of the 2006 Plan.

The Company recorded stock-based-compensation expense in the condensed consolidated statement of operations as follows (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2013	2012	2013
Cost of goods sold	\$ 125	\$ 335	\$ 355	\$ 601
Selling, general and administrative	1,695	3,944	4,804	10,709
Research and development	63	57	186	172
Stock-based compensation expense	\$ 1,883	\$ 4,336	5,345	\$ 11,482
Less: related income tax benefit	681	1,656	1,924	4,364
Stock-based compensation expense, net	<u>\$ 1,202</u>	<u>\$ 2,680</u>	<u>\$ 3,421</u>	<u>\$ 7,118</u>

As of March 31, 2013, total unrecognized compensation cost related to non-vested, share-based compensation grants was approximately \$17.9 million. The Company expects to recognize these costs over a weighted-average period of 2.1 years.

## Table of Contents

The following summarizes stock option activity during the nine months ended March 31, 2013:

	Number of Options	Weighted- Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)
Outstanding at June 30, 2012	1,059,397	\$ 23.01		
Granted	11,223	\$ 61.47		
Exercised	(116,059)	\$ 15.30		
Expired or forfeited	(11,158)	\$ 57.29		
Outstanding at March 31, 2013	<u>943,403</u>	<u>\$ 24.01</u>	<u>6.6 years</u>	<u>\$ 36,116</u>
Exercisable at March 31, 2013	<u>725,963</u>	<u>\$ 20.64</u>	<u>6.1 years</u>	<u>\$ 30,235</u>

A summary of restricted stock and restricted stock unit award activity during the nine months ended March 31, 2013:

	Shares	Weighted- Average Fair Value
Nonvested at June 30, 2012	580,468	\$ 28.93
Granted	276,562	57.49
Vested	(229,959)	25.88
Forfeited	(9,824)	41.18
Nonvested at March 31, 2013	<u>617,247</u>	<u>\$ 42.67</u>

As of March 31, 2013, there were 3,809,572 shares available for grant under the 2012 Plan. Under the terms of the 2012 Plan, RSU's and restricted stock granted from the pool of shares available for grant on or after December 12, 2012 reduce the pool by 1.87 shares for each share granted. RSU's and restricted stock forfeited and returned to the pool of shares available for grant increase the pool by 1.87 shares for each share forfeited.

## 6. Retirement Benefit Plans

The Company sponsors various retirement benefit plans including qualified and nonqualified defined benefit pension plans for its employees. The components of net periodic pension expense are as follows (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2013	2012	2013
Service cost	\$ 160	\$ 269	\$ 515	\$ 853
Amortization of prior service cost	112	229	336	689
Net periodic pension expense	<u>\$ 272</u>	<u>\$ 498</u>	<u>\$ 851</u>	<u>\$ 1,542</u>

For the three months ended March 31, 2012 and 2013, the Company made contributions of \$0.5 million and \$0.1 million, respectively to these defined benefit plans. For the nine months ended March 31, 2012 and 2013, the Company made contributions of \$0.6 million and \$0.1 million, respectively, to these defined benefit plans.

In addition, the Company maintains various defined contribution plans. For both the three months ended March 31, 2012 and 2013, the Company made contributions of \$0.9 million to these defined contribution plans. For the nine months ended March 31, 2012 and 2013, the Company made contributions of \$3.0 million and \$2.7 million, respectively, to these defined contribution plans.

## 7. Commitments and Contingencies

### Legal Proceedings

The Company is involved in various claims and legal proceedings arising in the ordinary course of business. In the Company's opinion after consultation with legal counsel, the ultimate disposition of such proceedings is not likely to have a material adverse effect on its business, financial condition or results of operations. The Company has not accrued for loss contingencies relating to such matters because the Company believes that, although unfavorable outcomes in the proceedings may be possible, they are not considered by management to be probable and reasonably estimable. If one or more of these matters are resolved in a manner adverse to the Company, the impact on the Company's business, financial condition or results of operations could be material.

*Contingent Acquisition Obligations*

Under the terms and conditions of the purchase agreements associated with certain acquisitions, the Company may be obligated to make additional payments based on the achievement of certain sales or profitability milestones from the acquired operations. The maximum amount of such payments under arrangements with contingent consideration caps is \$47 million. In addition, one of the purchase agreements the Company entered into requires royalty payments through 2022 based on the license of, or sales of products containing the technology of a company acquired in 2004. The Company accounts for such contingent payments as an addition to the purchase price of the acquired business for acquisitions that occurred prior to fiscal year 2010 under Statement of Financial Accounting Standards 141, “Business Combinations”. For acquisitions from and after the 2010 fiscal year and accounted for under Accounting Standards Codification 805, “Business Combinations” (“ASC 805”), the estimated fair value of these obligations is recorded as a liability in the condensed consolidated balance sheets with subsequent revisions reflected in the condensed consolidated statements of operations. As of March 31, 2013, pursuant to ASC 805, \$15.6 million of contingent payment obligations are included in Other long-term liabilities in the accompanying condensed consolidated balance sheet.

*Advances from Customers*

The Company receives advances from customers associated with certain projects. In fiscal 2012, the Company entered into an agreement with the Mexican government to provide a turnkey security screening solution along the country’s borders, and in its ports and airports . Associated with the agreement, the Company was provided an advance totaling \$100 million. The Company is obligated to provide a guarantee until the advance has been earned.

*Environmental Contingencies*

The Company is subject to various environmental laws. The Company’s practice is to conduct appropriate environmental investigations for each of its properties in the United States at which the Company manufactures products in order to identify, as of the date of such report, potential areas of environmental concern related to past and present activities or from nearby operations. In certain cases, the Company has conducted further environmental assessments consisting of soil and groundwater testing and other investigations deemed appropriate by independent environmental consultants.

During one investigation, the Company discovered soil and groundwater contamination at its Hawthorne, California facility. The Company’s site was previously used by other companies for semiconductor manufacturing similar to that presently conducted on the site by the Company, and it is not presently known who is responsible for the contamination or, if required, the remediation. The Company filed the requisite reports concerning this problem with the appropriate environmental authorities and is now working with the local governing agency, on a voluntary basis, to further characterize the contamination beneath the subject site to determine if any remediation would be necessary, and if so, the remediation methods and technologies most appropriate to eliminate and/or mitigate impacts to the local environment. The groundwater contamination is a known regional problem, not limited to the Company’s premises or its immediate surroundings. The Company has not accrued for loss contingencies relating to the above environmental matter because it believes that, although an unfavorable outcome may be possible, it is not considered by the Company’s management to be probable and reasonably estimable. If this matter is resolved in a manner adverse to the Company, the impact on the Company’s business, financial condition and results of operations could be material.

*Product Warranties*

The Company offers its customers warranties on many of the products that it sells. These warranties typically provide for repairs and maintenance of the products if problems arise during a specified time period after original shipment. Concurrent with the sale of products, the Company records a provision for estimated warranty expenses with a corresponding increase in cost of goods sold. The Company periodically adjusts this provision based on historical experience and anticipated expenses. The Company charges actual expenses of repairs under warranty, including parts and labor, to this provision when incurred.

The following table presents changes in warranty provisions (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2013	2012	2013
Balance at beginning of period	\$ 15,382	\$ 15,012	\$ 14,530	\$ 17,562
Additions	2,052	505	4,702	1,195
Reductions for warranty repair costs and adjustments	(1,297)	(1,554)	(3,095)	(4,794)
Balance at end of period	<u>\$ 16,137</u>	<u>\$ 13,963</u>	<u>16,137</u>	<u>\$ 13,963</u>

*Other Matters*

In November 2012, the Company received a “show cause” letter from the U.S. Transportation Safety Administration (TSA) regarding the Rapiscan Secure 1000SP Advanced Imaging Technology system and related Automated Target Recognition (ATR) software that were undergoing operational testing. The Company and the TSA reached an agreement under which the Company has agreed to assist the TSA in redeploying the Secure 1000SP units previously sold to the TSA and cease software development related to ATR. The Company’s contract with the TSA for AIT systems will continue, though the Company did not sell systems to the TSA in fiscal 2012 and fiscal 2013. The Company recorded \$2.7 million impairment and other charges in the second quarter of fiscal 2013 in connection with this agreement. Such costs include estimates for removing AIT units from TSA locations, outside legal costs to modify the contract, the write-off of capitalized software costs in conjunction with the development of the ATR software and the write-off of inventory related to the cancelled purchase order. Such charges were accrued as of December 31, 2012 as they became known and estimable for the first time during the quarter-ended December 31, 2012. However, such estimates may be revised in future periods as actual charges are incurred. The Company’s agreement with the TSA regarding the issues raised in the show cause letter does not constitute final resolution of the matter, as the issues are also subject to U.S. Department of Homeland Security (DHS) disposition. The Company is working to complete the process with the DHS.

**8. Income Taxes**

The provision for income taxes is determined using an effective tax rate that is subject to fluctuations during the year as new information is obtained. The assumptions used to estimate the annual effective tax rate includes factors such as the mix of pre-tax earnings in the various tax jurisdictions in which the Company operates, valuation allowances against deferred tax assets, increases or decreases in uncertain tax positions, utilization of research and development tax credits, and changes in or the interpretation of tax laws in jurisdictions where the Company conducts business. The Company recognizes deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of its assets and liabilities along with net operating loss and tax credit carryovers. The Company records a valuation allowance against its deferred tax assets to reduce the net carrying value to an amount that it believes is more likely than not to be realized. When the Company establishes or reduces the valuation allowance against its deferred tax assets, the provision for income taxes will increase or decrease, respectively, in the period such determination is made.

**9. Segment Information**

The Company has determined that it operates in three identifiable industry segments, (a) security and inspection systems (Security division), (b) medical monitoring and anesthesia systems (Healthcare division) and (c) optoelectronic devices and manufacturing (Optoelectronics and Manufacturing division). The Company also has a corporate segment (Corporate) that includes executive compensation and certain other general and administrative expenses; expenses related to stock issuances; and legal and audit and other professional service fees not allocated to product segments. Both the Security and Healthcare divisions comprise primarily end-product businesses whereas the businesses of the Optoelectronics and Manufacturing division primarily supplies components and subsystems to original equipment manufacturers, including to the Security and Healthcare divisions. Sales between divisions are at transfer prices that approximate market values. All other accounting policies of the segments are the same as described in Note 1, Summary of Significant Accounting Policies of the Form 10-K for the fiscal year ended June 30, 2012.

The following table presents segment and enterprise-wide information (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2013	2012	2013
Revenues — by Segment:				
Security division	\$ 111,796	\$ 99,840	\$ 273,370	\$ 274,619
Healthcare division	56,333	51,357	162,046	159,052
Optoelectronics and Manufacturing division, including intersegment revenues	49,975	54,761	154,425	169,185
Intersegment revenues elimination	(9,665)	(7,549)	(32,092)	(28,704)
Total	\$ 208,439	\$ 198,409	\$ 557,749	\$ 574,152

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2013	2012	2013
Operating income (loss) — by Segment:				
Security division	\$ 10,557	\$ 16,179	\$ 22,043	\$ 29,251
Healthcare division	6,254	3,593	16,977	14,389
Optoelectronics and Manufacturing division	3,558	3,271	12,947	13,561
Corporate	(2,552)	(4,017)	(8,458)	(9,704)
Eliminations (1)	388	388	245	709
Total	<u>\$ 18,205</u>	<u>\$ 19,414</u>	<u>\$ 44,114</u>	<u>\$ 48,206</u>
			June 30, 2012	March 31, 2013
Assets — by Segment:				
Security division			\$ 351,668	\$ 483,766
Healthcare division			162,583	163,826
Optoelectronics and Manufacturing division			132,281	152,882
Corporate			109,405	60,460
Eliminations (1)			(6,041)	(5,332)
Total			<u>\$ 749,896</u>	<u>\$ 855,602</u>

- (1) Eliminations within operating income primarily reflect the change in the elimination of intercompany profit in inventory not-yet-realized. Eliminations in assets reflect the amount of intercompany profit in inventory as of the balance sheet date. Such intercompany profit is to be realized upon shipment of inventory to the external customers of the Security and Healthcare divisions.

## Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

### Cautionary Statement

*This Quarterly Report on Form 10-Q contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward looking statements relate to expectations concerning matters that are not historical facts. Words such as “project”, “believe”, “anticipate”, “plan,” “expect”, “intend”, “may”, “should”, “likely to”, “could”, “will”, and “would” and small words and expressions are intended to identify forward-looking statements. Expectations described in the forward looking statements may prove to be inaccurate, and actual results may differ materially from those reflected in such expectations. Important factors that could cause our actual results to differ materially from those expectations are described in this Quarterly Report on Form 10-Q, our Annual Report on Form 10-K and other documents previously filed or hereafter filed by us from time to time with the Securities and Exchange Commission. Such factors, of course, do not include all factors that might affect our business and financial condition. Although we believe that the assumptions upon which our forward-looking statements are based are reasonable, such assumptions could prove to be inaccurate and actual results could differ materially from those expressed in or implied by the forward-looking statements. All forward-looking statements contained in this Quarterly Report on Form 10-Q are qualified in their entirety by this statement. We undertake no obligation other than as may be required under securities laws to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

### Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions and select accounting policies that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Our critical accounting policies are detailed in our Annual Report on Form 10-K for the year ended June 30, 2012.

### Recent Accounting Pronouncements

There are no recent accounting pronouncements that, if implemented, would impact us materially.

### Executive Summary

We are a vertically integrated designer and manufacturer of specialized electronic systems and components for critical applications, and provider of screening services. We sell our products and provide related services in diversified markets, including homeland security, healthcare, defense and aerospace. We have three operating divisions: (i) Security, (ii) Healthcare and (iii) Optoelectronics

and Manufacturing.

*Security Division.* Through our Security division, we design, manufacture and market security and inspection systems worldwide for sale primarily to U.S. and foreign government agencies, and provide turnkey security screening solutions. These products and services are used to inspect baggage, cargo, vehicles and other objects for weapons, explosives, drugs and other contraband as well as to screen people. Revenues from our Security division accounted for 48% and 49% of our total consolidated revenues for the nine months ended March 31, 2013 and 2012, respectively.

As a result of the terrorist attacks of September 11, 2001, and subsequent attacks in other locations worldwide, security and inspection products have increasingly been used at a wide range of facilities other than airports, such as border crossings, railway stations, seaports, cruise line terminals, freight forwarding operations, sporting venues, government and military installations and nuclear facilities. We believe that our wide-ranging product portfolio together with our ability to provide turnkey screening solutions position us to competitively pursue security and inspection opportunities as they arise throughout the world.

During our third quarter of fiscal 2012, our Security division won a six-year agreement with the Mexican government to provide a turnkey security screening solution along the country’s borders, and in its ports and airports. We have begun recognizing revenue under this agreement reported as service revenues.

In November 2012, we received a “show cause” letter from the U.S. Transportation Safety Administration (TSA) regarding the Rapiscan Secure 1000SP Advanced Imaging Technology system and related Automated Target Recognition (ATR) software that were undergoing operational testing. We reached an agreement with the TSA under which we have agreed to assist the TSA in redeploying the Secure 1000SP units previously sold to the TSA and cease software development related to ATR. Our contract with the TSA for AIT systems will continue, though we did not sell systems to the TSA in fiscal 2012 and fiscal 2013. We recorded \$2.7 million impairment and other charges during the second quarter of fiscal 2013 in connection with this agreement. Our agreement with the TSA regarding the issues raised in the show cause letter does not constitute final resolution of the matter, as the issues are also subject to U.S. Department of Homeland Security (DHS) disposition. We are working to complete the process with DHS.

*Healthcare Division.* Through our Healthcare division, we design, manufacture, market and service patient monitoring, diagnostic cardiology and anesthesia delivery and ventilation systems globally for sale primarily to hospitals and medical centers. Our products monitor patients in critical, emergency and perioperative care areas of the hospital and provide such information, through wired and wireless networks, to physicians and nurses who may be at the patient’s bedside, in another area of the hospital or even outside the hospital. Revenues from our Healthcare division accounted for 28% and 29% of our total consolidated revenues for the nine month periods ended March 31, 2013 and 2012, respectively.

The healthcare markets in which we operate are highly competitive. We believe that our customers choose among competing products on the basis of product performance, functionality, value and service. We also believe that the worldwide economic slowdown has caused some hospitals and healthcare providers to delay purchases of our products and services. During this period of uncertainty, we anticipated lower sales of patient monitoring, diagnostic cardiology and anesthesia systems products than what we had historically experienced, which negatively impacted our sales. Although there are indications that a recovery is underway, we cannot predict when the markets will fully recover and, therefore, when this period of delayed and diminished purchasing will end. A prolonged delay could have a material adverse effect on our business, financial condition and results of operations.

*Optoelectronics and Manufacturing Division.* Through our Optoelectronics and Manufacturing division, we design, manufacture and market optoelectronic devices and provide electronics manufacturing services worldwide for use in a broad range of applications, including aerospace and defense electronics, security and inspection systems, medical imaging and diagnostics, telecommunications, office automation, computer peripherals, industrial automation, automotive diagnostic systems and renewable energy. We also provide our optoelectronic devices and value-added manufacturing services to our own Security and Healthcare divisions. External revenues from our Optoelectronics and Manufacturing division accounted for 24% and 22% of our total consolidated revenues for both the nine months ended March 31, 2013 and 2012, respectively.

***Results of Operations for the Three Months Ended March 31, 2013 Compared to Three Months Ended March 31, 2012***

**Net Revenues**

The table below and the discussion that follows are based upon the way in which we analyze our business. See Note 9 to the condensed consolidated financial statements for additional information about our business segments.

<u>(in millions)</u>	<u>Q3 2012</u>	<u>% of Net Sales</u>	<u>Q3 2013</u>	<u>% of Net Sales</u>	<u>\$ Change</u>	<u>% Change</u>
Security division	\$ 111.8	54%	\$ 99.8	50%	\$ (12.0)	(11)%
Healthcare division	56.3	27%	51.4	26%	(4.9)	(9)%
Optoelectronics and Manufacturing division	40.3	19%	47.2	24%	6.9	17%
Total revenues	<u>\$ 208.4</u>	<u>100%</u>	<u>\$ 198.4</u>	<u>100%</u>	<u>\$ (10.0)</u>	<u>(5)%</u>

## Table of Contents

Total revenues for the three months ended March 31, 2013, decreased \$10.0 million, or 5%, to \$198.4 million, from \$208.4 million for the comparable prior-year period.

Revenues for the Security division for the three months ended March 31, 2013, decreased \$12.0 million, or 11%, to \$99.8 million, from \$111.8 million for the comparable prior-year period. In the prior year period, we recognized \$42 million in revenues related to a single large contract where we served as a prime contractor and hardware systems integrator. Excluding the change in revenues from this program, the Security division's sales increased by 41%, which was primarily attributable to our turnkey screening services and sales of cargo equipment.

Revenues for the Healthcare division for the three months ended March 31, 2013, decreased \$4.9 million, or 9%, to \$51.4 million, from \$56.3 million for the comparable prior-year period. The decrease was mainly attributable to a \$3.4 million, or 8%, decrease in patient monitoring product line revenues and to a \$1.0 million, or 12% decrease in cardiology product line revenues. Such decreases were predominately realized in our North American and Asian regions, as sales in our European, Middle Eastern and African region increased slightly over the prior year.

Revenues for the Optoelectronics and Manufacturing division for the three months ended March 31, 2013, increased by \$6.9 million, or 17%, to \$47.2 million, from \$40.3 million for the comparable prior-year period. This increase was attributable to a \$10.1 million increase in contract manufacturing sales partially offset by a \$3.2 million decrease in commercial optoelectronics sales.

### Gross Profit

(in millions)	Q3 2012	% of Net Sales	Q3 2013	% of Net Sales
Gross profit	\$ 69.1	33.2%	\$ 71.8	36.2%

Gross profit increased \$2.7 million, or 4%, to \$71.8 million for the three months ended March 31, 2013, from \$69.1 million for the comparable prior-year period. The gross margin increased to 36.2% from 33.2% for the comparable prior-year period. The increase was attributable to: i) increased revenue from turnkey screening services within our Security division, which provide significantly higher margins than product sales and ii) the impact of lower than average margin related to the single large contract where we served as a prime contractor and hardware systems integrator in the prior-year period. These improvements were partially offset by: i) the impact of the reduced revenue in our Healthcare division, which has historically generated the highest gross margin across the three divisions and ii) the impact of the increased revenue from our Optoelectronics and Manufacturing division, which historically generated the lowest gross margin across all three divisions.

### Operating Expenses

(in millions)	Q3 2012	% of Net Sales	Q3 2013	% of Net Sales	\$ Change	% Change
Selling, general and administrative	\$ 37.1	17.8%	\$ 37.8	19.0%	\$ 0.7	2%
Research and development	12.9	6.2%	12.3	6.2%	(0.6)	(5)%
Impairment, restructuring and other charges	0.9	0.4%	2.3	1.2%	1.4	156%
Total operating expenses	\$ 50.9	24.4%	\$ 52.4	26.4%	\$ 1.5	3%

**Selling, general and administrative expenses** . Selling, general and administrative (SG&A) expenses consist primarily of compensation paid to sales, marketing and administrative personnel, professional service fees and marketing expenses. For the three months ended March 31, 2013, SG&A expenses increased by \$0.7 million or 2%, to \$37.8 million from \$37.1 million for the comparable prior-year period. This \$0.7 million increase was attributable to an increase in bad debt expense offset by other cost savings. As a percentage of revenues, SG&A expenses were 19.0% for the three months ended March 31, 2013, compared to 17.8% for the comparable prior-year period. This increase was attributable to the lower sales level.

**Research and development** . Research and development (R&D) expenses include research related to new product development and product enhancement expenditures. For the three months ended March 31, 2013, such expenses decreased by \$0.6 million, or 5%, to \$12.4 million, from \$12.9 million for the comparable prior-year period. As a percentage of revenues, R&D expenses were unchanged at 6.2% for the three months ended March 31, 2012 and 2013.

**Impairment, restructuring and other charges** . In response to the challenging worldwide economic conditions, we continued to optimize our cost structure. In conjunction with these efforts, we incurred impairment, restructuring and other charges of \$2.3 million for the three months ended March 31, 2013, made up of a \$1.7 million charge in our Security division and a \$0.6 million charge in our Optoelectronics and Manufacturing division, primarily for employee severance. In the three months ended March 31, 2012, we incurred restructuring and other charges in our Optoelectronics and Manufacturing division of \$0.9 million, primarily for employee severance partly related to facility consolidation.

**Interest expense and other income, net** . For the three months ended March 31, 2013, interest expense and other income, net, amounted to \$1.3 million, as compared to \$0.8 million for the same prior-year period. The change in net expense was due to increased interest expense related to increased borrowings under our revolving credit facility to fund the investment in the Mexican turnkey services program, higher utilization of the letters-of-credit facility and the new mortgage debt associated with the acquisition of a building.

**Income taxes** . For the three months ended March 31, 2013, our income tax provision was \$4.5 million, compared to \$4.8 million for the comparable prior-year period. Our effective tax rate for the three months ended March 31, 2013, was 25.1%, including the benefit from the retroactive reinstatement of the federal research and experimentation credit, compared to 27.8% in the comparable prior-year period. Our provision for income taxes is dependent on the mix of income from U.S. and foreign locations due to tax rate differences among such countries as well as due to the impact of permanent taxable differences.

### *Results of Operations for the Nine Months Ended March 31, 2013 Compared to Nine Months Ended March 31, 2012*

#### **Net Revenues**

The table below and the discussion that follows are based upon the way in which we analyze our business. See Note 9 to the condensed consolidated financial statements for additional information about our business segments.

(in millions)	YTD Q3 2012	% of Net Sales	YTD Q3 2013	% of Net Sales	\$ Change	% Change
Security division	\$ 273.4	49%	\$ 274.6	48%	\$ 1.2	—
Healthcare division	162.0	29%	159.1	28%	(2.9)	(2)%
Optoelectronics and Manufacturing division	122.3	22%	140.5	24%	18.2	15%
Total revenues	<u>\$ 557.7</u>	<u>100%</u>	<u>\$ 574.2</u>	<u>100%</u>	<u>\$ 16.5</u>	<u>3%</u>

Net revenues for the nine months ended March 31, 2013 increased \$16.5 million, or 3%, to \$574.2 million, from \$557.7 million for the comparable prior-year period.

Revenues for the Security division for the nine months ended March 31, 2013 increased by \$1.2 million, to \$274.6 million, from \$273.4 million for the comparable prior-year period. The slight increase was primarily attributable to increased revenues from our turnkey screening services, offset by a decrease in equipment sales resulting primarily from the fulfillment in the prior year of a large contract under which we served as a prime contractor and hardware systems integrator.

Revenues for the Healthcare division for the nine months ended March 31, 2013, decreased \$2.9 million, or 2%, to \$159.1 million, from \$162.0 million for the comparable prior-year period. The decrease was primarily attributable to decreased sales in our European, Middle Eastern and African region and our Emerging Markets region partially offset by increased sales in our North American region. Among our product lines, the overall decrease included: (i) a \$1.7 million decrease in anesthesia product revenue and: (ii) a \$1.4 million decrease in cardiology product revenue; with our patient monitoring product revenues showing slight growth of \$0.4 million.

Revenues for the Optoelectronics and Manufacturing division for the nine months ended March 31, 2013, increased \$18.2 million, or 15%, to \$140.5 million, from \$122.3 million for the comparable prior-year period. This increase was attributable to a \$28.1 million increase in contract manufacturing sales partially offset by a \$10.0 million decrease in commercial optoelectronics sales.

#### **Gross Profit**

(in millions)	YTD Q3 2012	% of Net Sales	YTD Q3 2013	% of Net Sales
Gross profit	<u>\$ 187.8</u>	<u>33.7%</u>	<u>\$ 203.3</u>	<u>35.4%</u>

Gross profit increased \$15.5 million, or 8%, to \$203.3 million for the nine months ended March 31, 2013, from \$187.8 million for the comparable prior-year period. The gross margin during the period increased to 35.4% from 33.7% for the comparable prior-year

period. The increase was attributable to increased revenue from our turnkey screening services within our Security division, which provides significantly higher margins than product sales, and more than offset the decreased revenues in our Healthcare division, which has historically generated the highest gross margin among our three divisions, as well as the impact of the increased revenue from our Optoelectronics and Manufacturing division, which has historically generated the lowest gross margin across all three divisions.

### Operating Expenses

(in millions)	YTD Q3 2012	% of Net Sales	YTD Q3 2013	% of Net Sales	\$ Change	% Change
Selling, general and administrative	\$ 107.4	19.3%	\$ 114.5	19.9%	\$ 7.1	7%
Research and development	35.4	6.3%	35.6	6.2%	0.2	1%
Impairment, restructuring and other charges	0.9	0.2%	5.0	0.9%	4.1	456%
Total operating expenses	<u>\$ 143.7</u>	<u>25.8%</u>	<u>\$ 155.1</u>	<u>27.0%</u>	<u>\$ 11.4</u>	<u>8%</u>

**Selling, general and administrative expenses** . For the nine months ended March 31, 2013, SG&A expenses increased by \$7.1 million, or 7%, to \$114.5 million, from \$107.4 million for the comparable prior-year period. This \$7.1 million increase was primarily attributable to an increase in bad debt expense and the incremental costs in our Security division mainly related to supporting our turnkey screening services. As a percentage of revenues, SG&A expenses were 19.9% for the nine months ended March 31, 2013, compared to 19.3% for the comparable prior-year period.

**Research and development** . R&D expenses include research related to new product development and product enhancement expenditures. For the nine months ended March 31, 2013, such expenses increased \$0.2 million, or 1%, to \$35.6 million, from \$35.4 million for the comparable prior-year period. As a percentage of revenues, research and development expenses were 6.2% for the nine months ended March 31, 2013, compared to 6.3% for the comparable prior-year period. The increase in R&D expenses for the nine month period ended March 31, 2013, primarily resulted from an increase in R&D investment mainly in our Security division in support of multiple new product introductions.

**Impairment, restructuring and other charges** . In response to the challenging worldwide economic conditions, we continued to optimize our cost structure. In conjunction with these efforts, we incurred impairment, restructuring and other charges of \$5.0 million for the nine months ended March 31, 2013. This was made up of the \$2.7 million charge in conjunction with our agreement with the U.S. Transportation Security Administration and an additional \$1.7 million charge in our Security division and a \$0.6 million charge in our Optoelectronics and Manufacturing division, primarily for employee severance. During the nine months ended March 31, 2012, we incurred restructuring and other charges of \$0.9 million in our Optoelectronics and Manufacturing division, primarily for employee severance partly related to facility consolidation.

**Interest expense and other income, net** . For the nine months ended March 31, 2013, interest expense and other income, net, amounted to \$3.8 million as compared to \$2.3 million for the same prior-year period. The increase was primarily due to higher utilization of the letters-of-credit facility, the new mortgage debt associated with the acquisition of a building and an increase in revolver borrowings to fund the investment in our Mexican turnkey services program.

**Income taxes** . For the nine months ended March 31, 2013, our income tax provision was \$12.1 million, compared to \$12.2 million for the comparable prior-year period. Our effective tax rate for the nine months ended March 31, 2013, was 27.3%, compared to 29.1% in the comparable prior-year period. Our provision for income taxes is dependent on the mix of income from U.S. and foreign locations due to tax rate differences among such countries as well the impact of permanent taxable differences.

### Liquidity and Capital Resources

To date, we have financed our operations primarily through cash flow from operations, proceeds from equity issuances and our credit facilities. Cash and cash equivalents totaled \$47.7 million at March 31, 2013, a decrease of \$43.8 million from \$91.5 million at June 30, 2012. The changes in our working capital and cash and cash equivalent balances during the nine months ended March 31, 2013 are described below.

(in millions)	June 30, 2012	March 31, 2013	% Change
Working capital	\$ 322.5	\$ 216.5	(33)%
Cash and cash equivalents	91.5	47.7	(48)%

**Working Capital**. During the nine months ended March 31, 2013, we utilized cash on-hand and drew down on our revolving credit facility to fund the preparation of our turnkey screening solutions program in Mexico, including capital spending of over \$100 million.

(in millions)	YTD Q3 2012	YTD Q3 2013	\$ Change
Cash provided by operating activities	\$ 86.2	\$ 57.2	\$ (29.0)
Cash used in investing activities	(50.5)	(149.3)	(98.8)
Cash provided by financing activities	1.0	49.1	48.1

*Cash Provided by Operating Activities.* Cash flows from operating activities can fluctuate significantly from period to period, as net income, tax timing differences, customer collections, vendor payments and other items can significantly impact cash flows. Net cash provided by operations for the nine months ended March 31, 2013 was \$57.2 million, a decrease of \$29.0 million from the \$86.2 million provided in the comparable prior-year period. This decrease in net cash provided was primarily due to changes in working capital in the current-year period versus the prior-year period resulting from: (i) a \$100 million customer advance received in the prior-year related to our turnkey screening services program in Mexico, and (ii) a \$9.5 million decrease in cash from changes in other accrued expenses and other current liabilities. These unfavorable changes were partially offset by increases in net cash provided such as (i) a \$28.7 million increase in cash from changes in inventory, (ii) a \$28.3 million increase from changes in accounts payable; (iii) an \$18.8 increase in cash from changes in prepaid expenses and other current assets; and (iv) a \$14.8 million increase in net income for the nine months ended March 31, 2013, after giving consideration to non-cash operating items including depreciation and amortization, stock-based compensation and deferred taxes, among others.

*Cash Used in Investing Activities.* Net cash used in investing activities was \$149.3 million for the nine months ended March 31, 2013, compared to \$50.5 million for the nine months ended March 31, 2012. During the nine months ended March 31, 2013, we invested \$139.4 million in capital expenditures primarily in our Security division related to the fulfillment of our large turnkey screening services program in Mexico and the acquisition of land and a building which will serve as our Healthcare divisions new headquarters, as compared to \$44.3 million in capital expenditures during the comparable prior-year period. During the nine months ended March 31, 2013, we also used \$6.1 million for the acquisition of businesses, as compared to \$3.2 million during the comparable prior-year period.

*Cash Provided by Financing Activities.* Net cash provided by financing activities was \$49.1 million for the nine months ended March 31, 2013, compared to net cash provided by financing activities of \$1.0 million for the nine months ended March 31, 2012. During the nine months ended March 31, 2013, \$55.0 million in cash was provided from our bank revolving credit facility primarily to fund our capital spending. During this period, we also financed the acquisition of land and a building through an \$11.1 million term loan. In addition, during the nine months ended March 31, 2013 we received \$4.6 million in net proceeds from the exercise of stock options and the purchase of stock under our employee stock purchase plan compared to \$4.8 million in proceeds from the exercise of stock options and the purchase of stock under our employee stock purchase plan in the prior period. Finally, during the nine months ended March 31, 2013, we used \$20.7 million of cash to repurchase shares of our common stock under our stock repurchase program and settle tax obligations arising out of our stock plans as compared to using \$3.7 million of cash to repurchase shares of our common stock under our stock repurchase program and settle tax obligations arising out of our stock plans in the prior-year period.

## Borrowings

Outstanding lines of credit and current and long-term debt totaled \$67.9 million at March 31, 2013, an increase of \$64.9 million from \$3.0 million at June 30, 2012. See Note 4 to the condensed consolidated financial statements for further discussion.

## Stock Repurchase Program

Our Board of Directors originally authorized a stock repurchase program in March 1999 for up to 2,000,000 shares of our common stock. In September 2004 our Board of Directors increased the number of shares authorized for repurchase by 1,000,000 shares. In April of 2013, our Board of Directors increased the number of shares authorized for repurchase by an additional 1,000,000 shares, bringing the aggregate number of shares authorized for repurchase under the program to 4,000,000 shares of common stock. This program does not have an expiration date. The Company's stock purchase program does not obligate it to acquire any specific number of shares.

The following table presents the shares acquired during the period:

	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of program	Maximum number of shares that may yet be purchased as of March 31, 2013
January 1, 2013 to January 31, 2013	—		—	
February 1, 2013 to February 28, 2013	141,887	\$ 56.70	141,887	
March 1, 2013 to March 31, 2013	—		—	
	<u>141,887</u>	<u>\$ 56.70</u>	<u>141,887</u>	<u>410,040</u>

## **Dividend Policy**

We have never paid cash dividends on our common stock and have no plans to do so in the foreseeable future.

## **Contractual Obligations**

We presented our contractual obligations in our Annual Report on Form 10-K for the fiscal year ended June 30, 2012. See Note 7 to the condensed consolidated financial statements for further discussion regarding those obligations during the first nine months of fiscal 2013.

## **Off Balance Sheet Arrangements**

As of March 31, 2013, we did not have any significant off balance sheet arrangements as defined in Item 303(a)(4) of Regulation S-K.

## **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

For the nine months ended March 31, 2013, no material changes occurred with respect to market risk as disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2012.

### **Market Risk**

We are exposed to certain market risks, which are inherent in our financial instruments and arise from transactions entered into in the normal course of business. We may enter into derivative financial instrument transactions in order to manage or reduce market risk in connection with specific foreign-currency-denominated transactions. We do not enter into derivative financial instrument transactions for speculative purposes.

We are subject to interest rate risk on our short-term borrowings under our bank lines of credit. Borrowings under these lines of credit do not give rise to significant interest rate risk because these borrowings have short maturities and are borrowed at variable interest rates. Historically, we have not experienced material gains or losses due to interest rate changes.

### **Foreign Currency**

We maintain the accounts of our operations in each of the following countries in the following currencies: Finland (Euros), France (Euros), Germany (Euros), Italy (Euros) and Greece (Euros), Singapore (U.S. dollars), Malaysia (U.S. dollars), United Kingdom (U.K. pounds), Norway (Norwegian kroners), India (Indian rupees), Indonesia (Indonesian rupiah), China (Chinese yuan), Canada (Canadian dollars), Mexico (Mexican pesos and U.S. dollars), Australia (Australian dollars) and Cyprus (Cypriot pounds). Foreign currency financial statements are translated into U.S. dollars at period-end rates, except that revenues, costs and expenses are translated at average rates during the reporting period. We include gains and losses resulting from foreign currency transactions in income, while we exclude those resulting from translation of financial statements from income and include them as a component of other comprehensive income. Transaction gains and losses, which were included in our condensed consolidated statements of operations, amounted to a loss of \$0.3 million during the three months ended March 31, 2012 and a gain of \$3.0 million during the three months ended March 31, 2013, respectively. For the nine months ended March 31, 2012, we had net zero impact from foreign exchange and a gain of \$2.5 million for the nine months ended March 31, 2013. A 10% appreciation of the U.S. dollar relative to each of the local currencies would have resulted in a net increase in our operating income of approximately \$2 million in the third quarter of fiscal 2013. Conversely, a 10% depreciation of the U.S. dollar relative to each of the local currencies would have resulted in a net decrease in our operating income of approximately \$2 million in the third quarter of fiscal 2013.

### **Use of Derivatives**

Our use of derivatives consists primarily of foreign exchange contracts. As discussed in Note 1 to the condensed consolidated financial statements, we had foreign currency forward contracts of approximately \$22.6 million outstanding and an interest rate swap of \$10.3 million outstanding as of March 31, 2013.

### **Importance of International Markets**

International markets provide us with significant growth opportunities. As a result of our worldwide business operations, we are, however, subject to various risks, including: international regulatory requirements and policy changes; difficulties in accounts receivable collection and the management of distributors; geopolitical and economic instability, currency exchange rate fluctuations;

and tariff regulations. In response to these risks and others, we continue to perform ongoing credit evaluations of our customers' financial condition and, if deemed necessary, we require advance payments for sales. Also, we monitor geopolitical, economic and currency conditions around the world to evaluate whether there may be any significant effect on our international sales in the future.

### **Inflation**

We do not believe that inflation had a material impact on our results of operations during the three and nine months ended March 31, 2013.

### **Interest Rate Risk**

We classify all highly liquid investments with maturities of three months or less as cash equivalents and record them on our balance sheet at fair value.

### **Indemnification**

The Company has entered into indemnification agreements with its directors and executive officers. Under these agreements, the Company has agreed to indemnify such individuals to the fullest extent permitted by law against liabilities that arise by reason of their status as directors or officers and to advance expenses incurred by such individuals in connection with related legal proceedings. It is not possible to determine the maximum potential amount of payments the Company could be required to make under these agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each claim. However, the Company maintains directors and officers liability insurance coverage to reduce its exposure to such obligations. To date, no such payments have been made under these agreements.

## **Item 4. Controls and Procedures**

### *Evaluation of Disclosure Controls and Procedures*

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) that are designed to ensure that information required to be disclosed in our reports under the Exchange Act is processed, recorded, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure.

We carried out an evaluation, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2013, the end of the period covered by this report. Based upon that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of March 31, 2013.

### *Changes in Internal Control over Financial Reporting*

There were no changes in our internal control over financial reporting during the second quarter of fiscal 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### *Limitations on Effectiveness of Controls and Procedures*

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

## **PART II OTHER INFORMATION**

### **Item 1. Legal Proceedings**

We are involved in various claims and legal proceedings arising in the ordinary course of business. In our opinion, after consultation with legal counsel, the ultimate disposition of such proceedings will not have a material adverse effect on our business, financial condition or results of operations.

**Item 1A. Risk Factors**

Set forth below and elsewhere in this report and in other documents we file with the SEC are descriptions of the risks and uncertainties that could cause our actual results to differ materially from the results contemplated by the forward-looking statements contained in this report. We encourage you to carefully consider all of the following risk factors when making investment decisions regarding our company. If any of the following risks materialize, our business, financial condition and operating results could be materially adversely affected.

*Fluctuations in our operating results may cause our stock price to decline.*

Given the nature of the markets in which we participate, it is difficult to reliably predict future revenues and profitability. Changes in competitive, market and economic conditions may cause us to adjust our operations. A high proportion of our costs are fixed, due in part to our significant sales, research and development and manufacturing costs. Thus, small declines in revenue could disproportionately affect our operating results. Factors that may affect our operating results and/or the market price of our Common Stock include:

- demand for and market acceptance of our products;
- competitive pressures resulting in lower selling prices;
- adverse changes in the level of economic activity in regions in which we do business;
- low or fluctuating levels of political stability in regions in which we do business;
- adverse changes in industries, such as semiconductors and electronics, on which we are particularly dependent;
- changes in the portions of our revenue represented by various products and customers;
- delays or problems in the introduction of new products;
- announcements or introductions of new products, services or technological innovations by our competitors;
- variations in our product mix;
- timing and amount of our expenditures in anticipation of future sales;
- availability of equity and credit markets to provide our customers with funding to make equipment purchases;
- public guidance that we provide regarding future financial results based on facts, judgments and assumptions made at the time of the publication of the guidance, all of which may change after the publication of the guidance;
- exchange rate fluctuations;
- increased costs of raw materials or supplies;
- changes in the volume or timing of product orders;
- timing of completion of acceptance testing of some of our products;
- changes in regulatory requirements;

- natural disasters; and
- changes in general economic factors.

***Unfavorable currency exchange rate fluctuations could adversely affect our profitability.***

Our international sales and our operations in foreign countries expose us to risks associated with fluctuating currency values and exchange rates. Gains and losses on the conversion of accounts receivable, accounts payable and other monetary assets and liabilities to U.S. dollars may contribute to fluctuations in our results of operations. In addition, increases or decreases in the value of the U.S. dollar relative to other currencies could have an adverse effect on our results of operations.

***We face aggressive competition in each of our operating divisions. If we do not compete effectively, our business will be harmed.***

We encounter aggressive competition from numerous competitors in each of our divisions. In the security and inspection and patient monitoring, diagnostic cardiology and anesthesia systems markets, competition is based primarily on such factors as product performance, functionality and quality, cost, prior customer relationships, technological capabilities of the product, price, certification by government authorities, local market presence and breadth of sales and service organization. In the optoelectronic devices and electronics manufacturing markets, competition is based primarily on factors such as expertise in the design and development of optoelectronic devices, product quality, timeliness of delivery, price, customer technical support and on the ability to provide fully-integrated services from application development and design through volume subsystem production. We may not be able to compete effectively with all of our competitors. To remain competitive, we must develop new products and enhance our existing products and services in a timely manner. We anticipate that we may have to adjust the prices of many of our products to stay competitive. In addition, new competitors may emerge and entire product lines or service offerings may be threatened by new technologies or market trends that reduce the value of these product lines or service offerings.

***The September 11, 2001 terrorist attacks, subsequent attacks in other locations worldwide and the creation of the U.S. Department of Homeland Security have increased financial expectations that may not materialize.***

The September 11, 2001 terrorist attacks, subsequent attacks in other locations worldwide and the creation of the U.S. Department of Homeland Security have created increased interest in our security and inspection systems. However, we are not certain whether the level of demand will continue to be as high as it is now. We do not know what solutions will continue to be adopted by the U.S. Department of Homeland Security, the U.S. Department of Defense, and similar agencies in other countries and whether our products will be a part of those solutions. Additionally, should our products be considered as a part of the future security solutions, it is unclear what the level may be and how quickly funding to purchase our products may be made available. These factors may adversely impact us and create unpredictability in revenues and operating results.

***If operators of, or algorithms installed in, our security and inspection systems fail to detect weapons, explosives or other devices that are used to commit a terrorist act, we could be exposed to product and professional liability and related claims for which we may not have adequate insurance coverage.***

Our business exposes us to potential product liability risks that are inherent in the development, manufacturing, sale and service of security and inspection systems as well as in the provision of training to our customers in the use and operation of such systems. Our customers use our security and inspection systems to help them detect items that could be used in performing terrorist acts or other crimes. Some of our security and inspection systems require that an operator interpret an image of suspicious items within a bag, parcel, container or other vessel. Others signal to the operator that further investigation is required. In either case, the training, reliability and competence of the customer's operator are crucial to the detection of suspicious items.

Security inspection systems that signal to the operator that further investigation is required are sometimes referred to in the security industry as “automatic” detection systems. Such systems utilize software algorithms (often designed to meet government requirements) to interpret data produced by the system and to signal to the operator when a dangerous object may be present. Such algorithms are probabilistic in nature and are also subject to significant technical limitations. Nevertheless, if such a system were to fail to signal to an operator when an explosive or other contraband was in fact present, resulting in significant damage, we could become the subject of significant product liability claims.

Furthermore, security inspection by technological means is circumstance and application-specific. Our security and inspection systems are not designed to work under all circumstances and can malfunction.

We also offer turnkey security screening solutions under which we perform certain of the security screening tasks that have historically been performed by our customers. Such tasks include: design, layout and construction of the security checkpoint where the inspection equipment is located; selection of the security equipment to be used at the checkpoint; selection, training and management of the personnel operating the checkpoint; operation of the security screening equipment ; interpretation of the images and other signals produced by the security screening equipment; maintenance and security of the checkpoint as well as other related services. Such projects expose us to certain professional liability risks that are inherent in performing security inspection services (in live checkpoint environments and over extended periods of time) for the purpose of assisting our customers in the detection of contraband items, including items that could be used in performing terrorist acts or other crimes. If a contraband item were to pass through the checkpoint and be used to perform a terrorist act or other crime, we could become the subject of significant professional liability claims.

In addition, there are also many other factors beyond our control that could lead to liability claims should an act of terrorism occur. The 1993 World Trade Center bombing, the September 11, 2001 attacks, subsequent attacks in other locations worldwide and the potential for future attacks, have caused commercial insurance for such threats to become extremely difficult to obtain. Although we have been able to obtain insurance coverage, it is likely that, should we be found liable following a major act of terrorism, the insurance we currently have in place would not fully cover the claims for damages.

***The Support Anti-terrorism by Fostering Effective Technologies Act of 2002 (SAFETY Act) may not shield us against all legal claims we may face following an act of terrorism.***

The SAFETY Act provides important legal liability protections for providers of qualified anti-terrorism products and services. Under the SAFETY Act, providers, such as our Security division, may apply to the U.S. Department of Homeland Security for coverage of the products and services. If granted coverage, such providers would receive certain legal protections against product liability, professional liability and certain other claims that could arise following an act of terrorism.

We have applied to the U.S. Department of Homeland Security for many of the products and services offered by our Security division but we do not enjoy coverage (or the highest level of coverage) for every product line, model number and service offering that our Security division provides. In addition, the terms of the SAFETY Act coverage decisions awarded to us by the U.S. Department of Homeland Security contain conditions and requirements that we may not (or may not be able to) continue to satisfy in the future.

In the future, if we fail to maintain the coverage that we currently enjoy or fail to timely apply for coverage for new products and services as we introduce them, or if the U.S. Department of Homeland Security limits the scope of any coverage previously awarded to us, denies us coverage or continued coverage for a particular product, product line or service offering, or delays in making decisions about whether to grant us coverage, we may become exposed to legal claims that the SAFETY Act was otherwise designed to prevent.

The SAFETY Act was not designed to shield providers of qualified anti-terrorism products and services from all types of claims that may arise from acts of terrorism, including from many types of claims lodged in courts outside of the United States or acts of terrorism that occur outside of the United States. This too could leave us exposed to significant legal claims and litigation defense costs despite the SAFETY Act awards we have received.

***Our patient monitoring, diagnostic cardiology and anesthesia systems could give rise to product liability claims and product recall events that could materially and adversely affect our financial condition and results of operations.***

The development, manufacturing and sale of medical devices expose us to significant risk of product liability claims, product recalls and, sometimes, product failure claims. We face an inherent business risk of financial exposure to product liability claims if the use of our medical devices results in personal injury or death. Substantial product liability litigation currently exists within the medical device industry. Some of our patient monitoring, diagnostic cardiology and anesthesia systems products may become subject to product liability claims and/or product recalls. Future product liability claims and/or product recall costs may exceed the limits of our insurance coverages or such insurance may not continue to be available to us on commercially reasonable terms, or at all. In addition, a significant product liability claim or product recall could significantly damage our reputation for producing safe, reliable and effective products, making it more difficult for us to market and sell our products in the future. Consequently, a product liability claim, product recall or other claim could have a material adverse effect on our business, financial condition, operating results and cash flows.

***If we are unable to sustain high quality processes for the manufacture and delivery of goods and services, our reputation could be harmed, our competitive advantage could erode and we could incur significant costs.***

Quality is extremely important to us and our customers due in part to the serious consequences of product failure. Our quality certifications are critical both to the marketing success of our goods and services and to the satisfaction of both regulatory and contractual requirements under which we sell many of our products. If we fail to meet these standards or other standards required in our industries, we could lose customers and market share, our revenue could decline and we could face significant costs and other liabilities.

***The loss of certain of our customers, including government agencies that can modify or terminate agreements more easily than other commercial customers with which we contract, could have a negative effect on our reputation and could have a material adverse effect on our business, financial condition and results of operations.***

We sell many of our products to prominent, well-respected institutions, including agencies and departments of the U.S. Government, state and local governments, foreign governments, renowned hospitals and hospital networks, and large military-defense and space-industry contractors. Many of these larger customers spend considerable resources testing and evaluating our products and our design and manufacturing processes and services. Some of our smaller customers know this and rely on this as an indication of the high-quality and reliability of our products and services. As a result, part of our reputation and success depends on our ability to continue to sell to larger institutions that are known for demanding high standards of excellence.

The loss or termination of a contract by such an institution, even if for reasons unrelated to the quality of our products or services, could therefore have a more wide-spread and potentially material adverse effect on our business, financial condition and results of operations. In particular, government contracts typically contain provisions and are subject to laws and regulations that give the government agencies rights and remedies not typically found in commercial contracts, including providing the government agency with the ability to unilaterally:

- terminate our existing contracts;
- reduce the value of our existing contracts;
- modify some of the terms and conditions in our existing contracts;
- suspend or permanently prohibit us from doing business with the government or with any specific government agency;
- control and potentially prohibit the export of our products;
- cancel or delay existing multiyear contracts and related orders if the necessary funds for contract performance for any subsequent year are not appropriated;
- decline to exercise an option to extend an existing multiyear contract; and
- claim rights in technologies and systems invented, developed or produced by us.

Most U.S. government agencies and some other agencies with which we contract can terminate their contracts with us for convenience, and in that event we generally may recover only our incurred or committed costs, settlement expenses and profit on the work completed prior to termination. If an agency terminates a contract with us for default, we may be denied any recovery and may be liable for excess costs incurred by the agency in procuring undelivered items from an alternative source. We may receive notices under such contracts that, if not addressed to the agency's satisfaction, could give the agency the right to terminate those contracts for default or to cease procuring our services under those contracts. We received such a "show cause" letter in November 2012 from the U.S. Transportation Safety Administration (TSA), and though we reached a subsequent agreement with the TSA, such agreement does not constitute final resolution, as the issues are also subject to disposition by the U.S. Department of Homeland Security.

Further, we are generating increasing revenues from certain customers, the loss of which could have a material adverse effect on our business. In particular, in January 2012, we entered into a six-year contract with the Mexican government to provide a turnkey security screening solution along the country's borders, and in its ports and airports. This project is expected to provide significant revenues over the life of the contract and will require substantial management and financial resources for capital equipment and infrastructure in anticipation of future revenues and result in substantial cash-flow volatility, particularly over fiscal year 2013. Additionally, another significant contract with the U.S. Army for our performance as a prime contractor and hardware systems integrator, awarded in September 2011, was substantially recognized in fiscal year 2012, further contributing to potential volatility.

***Our revenues are dependent on orders of security and inspection systems, turnkey security screening solutions and patient monitoring, diagnostic cardiology and anesthesia systems, which may have lengthy and unpredictable sales cycles.***

Sales of security and inspection systems and turnkey security screening solutions often depend upon the decision of governmental agencies to upgrade or expand existing airports, border crossing inspection sites, seaport

inspection sites, military facilities and other security installations. In the case of turnkey security screening solutions, the commencement of screening operations may be dependent on the approval, by a government agency, of the protocols and procedures that our personnel are to follow during the performance of their activities. Sales outside of the United States of our patient monitoring, diagnostic cardiology and anesthesia systems depend in significant part on the decision of governmental agencies to build new medical facilities or to expand or update existing medical facilities. Accordingly, a significant portion of our sales of security and inspection systems, turnkey security screening solutions and our patient monitoring, diagnostic cardiology and anesthesia systems is often subject to delays associated with the lengthy approval processes. During these approval periods, we expend significant financial and management resources in anticipation of future revenues that may not occur. If we fail to receive such revenues after expending such resources, such failure could have a material adverse effect on our business, financial condition and results of operations.

***Current economic conditions, including the slow pace of recovery from recession in the United States and other parts of the world, as well as further disruptions in the financial markets could result in substantial declines in our revenues, earnings, cash flows and financial condition.***

The worldwide economic slowdown has and could continue to adversely affect our businesses and our profitability. If economic growth continues to remain slow, many customers may continue to delay purchases or reduce purchase quantities. This could result in the reduction in sales of certain of our products, slower adoption of both new technologies and upgrades to existing technologies and could also result in increased price competition. Continued market disruptions and broader economic downturns also increase our exposure to losses from bad debts. Among other effects we have seen during the slowdown, some of our customers, such as hospitals and healthcare systems in Europe and the United States, who rely on the credit markets for access to capital, have and may continue to delay purchases of our products and services until the credit markets recover. If economic or other factors cause financial institutions to fail, we could lose current or potential customers. We cannot predict when the world's credit markets will recover and therefore when this period of delayed and diminished purchasing will end. A prolonged delay could have a material adverse effect on our business, financial condition and results of operations. Any or all of these factors, as well as other consequences of the current economic conditions which cannot currently be anticipated, could have a material adverse effect on our revenues, earnings and cash flows and otherwise adversely affect our financial condition.

***We have limited operating experience with our screening solutions business. If we fail to perform on our existing agreements to provide security screening solutions to customers after expending substantial resources, such failure could have a material adverse effect on our business, financial condition and results of operations.***

Although our S2 business has a limited operating history, we have recently entered into significant large-scale agreements to provide turnkey security screening solutions to certain customers. In particular, in January 2012, we entered into a substantial six-year contract with the Mexican government to provide a turnkey security screening solution along the country's borders, and in its ports and airports. The contract is expected to provide significant revenues over the life of the contract. However, this contract requires substantial management and financial resources for capital equipment and infrastructure in anticipation of future revenues, as well as other performance risks. Under the agreement, we were provided an advance of \$100 million, however, we are obligated to provide a guarantee until the advance has been earned. If we fail to receive such revenues after expending such resources, such failure could have a material adverse effect on our business, financial condition and results of operations.

***If we do not introduce new products in a timely manner, our products could become obsolete and our operating results would suffer.***

We sell many of our products in industries characterized by rapid technological changes, frequent new product and service introductions and evolving industry standards and customer needs. Without the timely introduction of new products and enhancements, our products could become technologically obsolete over time, in which case our revenue and operating results would suffer. The success of our new product offerings will depend upon several factors, including our ability to:

- accurately anticipate customer needs;

- innovate and develop new technologies and applications;
- successfully commercialize new technologies in a timely manner;
- price our products competitively and manufacture and deliver our products in sufficient volumes and on time; and
- differentiate our offerings from our competitors' offerings.

Some of our products are used by our customers to develop, test and manufacture their products. We therefore must anticipate industry trends and develop products in advance of the commercialization of our customers(2) products. In developing any new product, we may be required to make a substantial investment before we can determine the commercial viability of the new product. If we fail to accurately foresee our customers(2) needs and future activities, we may invest heavily in research and development of products that do not lead to significant revenues.

***Interruptions in our ability to purchase raw materials and subcomponents may adversely affect our profitability.***

We purchase raw materials and certain subcomponents from third parties. Standard purchase order terms are as long as one year at fixed costs, but we do not have guaranteed long-term supply arrangements with our suppliers. In addition, for certain raw materials and subcomponents that we use, there are a limited number of potential suppliers that we have qualified or that we are currently able to qualify. Consequently, some of the key raw materials and subcomponents that we use are currently available to us only from a single vendor. The reliance on a single qualified vendor could result in delays in delivering products or increases in the cost of manufacturing the affected products. Any material interruption in our ability to purchase necessary raw materials or subcomponents could adversely affect our ability to fulfill customer orders and therefore could ultimately have a material adverse effect on our business, financial condition and results of operations.

***Delays by the construction firms we engage may interfere with our ability to complete projects on time.***

Purchasers of our security and inspection systems and turnkey security screening solutions sometimes require, as a part of our contract, the construction of the facilities that will house our systems and/or operations. Some of these construction projects are significant in size and complexity. We engage qualified construction firms to perform this work. However, if such firms experience delays, if they perform sub-standard work or if we fail to properly monitor the quality of their work or the timeliness of their progress, we may not be able to complete our construction projects on time. In any such circumstance, we could face the imposition of delay penalties and breach of contract claims by our customer. In addition, we could be forced to incur significant expenses to rectify the problems caused by the construction firm. Any material delay caused by our construction firm subcontractors could therefore ultimately have a material adverse effect on our business, financial condition and results of operations.

***We may not be able to successfully implement our acquisitions and investment strategies, integrate acquired businesses into our existing business or make acquired businesses profitable.***

One of our strategies is to supplement our internal growth by acquiring and investing in businesses and technologies that complement or augment our existing product lines. This growth has placed, and may continue to place, significant demands on our management, working capital and financial resources. We may be unable to identify or complete promising acquisitions for many reasons, including:

- competition among buyers;
- the need for regulatory approvals, including antitrust approvals; and
- the high valuations of businesses.

Some of the businesses we may seek to acquire or invest in may be marginally profitable or unprofitable. For these businesses to achieve acceptable levels of profitability, we must improve their management, operations,

products and market penetration. We may not be successful in this regard and we may encounter other difficulties in integrating acquired businesses into our existing operations.

To finance our acquisitions, we may have to raise additional funds, through either public or private financings. We may be unable to obtain such funds or may be able to do so only on unfavorable terms.

***Our acquisition and alliance activities could disrupt our ongoing business.***

We intend to continue to make investments in companies, products and technologies, either through acquisitions, investments or alliances. Acquisition and alliance activities often involve risks, including:

- difficulty in assimilating the acquired operations and employees and realizing synergies expected to result from the acquisition;
- difficulty in managing product co-development activities with our alliance partners;
- difficulty in retaining the key employees of the acquired operation;
- disruption of our ongoing business;
- inability to successfully integrate the acquired technologies and operations into our businesses and maintain uniform standards, controls, policies and procedures; and
- lacking the experience necessary to enter into new product or technology markets successfully.

Integrating acquired businesses has been and will continue to be complex, time consuming and expensive, and can negatively impact the effectiveness of our internal control over financial reporting. The use of debt to fund acquisitions or for other related purposes increases our interest expense and leverage. If we issue equity securities as consideration in an acquisition, current stockholders' percentage ownership and earnings per share may be diluted. As a result of these and other risks, we cannot be certain that our previous or future acquisitions will be successful and will not materially adversely affect the conduct, operating results or financial condition of our business.

***Acquisition and alliance activities by our competitors could disrupt our ongoing business.***

From time to time, our competitors acquire or enter into exclusive arrangements with companies with whom we do business or may do business in the future. Reductions in the number of partners with whom we may do business in a particular context may reduce our ability to enter into critical alliances on attractive terms or at all, and the termination of an existing alliance by a business partner may disrupt our operations.

***Our ability to successfully adapt to ongoing organizational changes could impact our business results.***

We have executed a number of significant business and organizational changes to rationalize our overall cost structure. These changes have included and may continue to include the implementation of cost-cutting measures and the consolidation of facilities. We expect these types of changes may continue from time to time in the future as we uncover additional opportunities to streamline our operations. Successfully managing these changes is critical to our productivity improvement and business success. If we are unable to successfully manage these changes, while continuing to invest in business growth, our financial results could be adversely impacted.

***Economic, political and other risks associated with international sales and operations could adversely affect our financial performance.***

Since we sell certain of our products worldwide, our businesses are subject to risks associated with doing business internationally. We anticipate that revenues from international operations will continue to represent a substantial portion of our total revenue. In addition, many of our manufacturing facilities, and therefore employees,

suppliers, real property, capital equipment, cash and other assets are located outside the United States. Accordingly, our future results could be harmed by a variety of factors, including:

- changes in foreign currency exchange rates;
- changes in a country's or region's political or economic conditions, particularly in developing or emerging markets;
- political and economic instability, including the possibility of civil unrest, terrorism, mass violence or armed conflict;
- longer payment cycles of foreign customers and difficulty of collecting receivables in foreign jurisdictions;
- trade protection measures and import or export licensing requirements;
- differing legal and court systems;
- differing tax laws and changes in those laws;
- difficulty in staffing and managing widespread operations;
- difficulty in managing distributors and sales agents and their compliance with applicable laws;
- differing labor laws and changes in those laws;
- differing protection of intellectual property and changes in that protection; and
- differing regulatory requirements and changes in those requirements.

***Third parties may claim we are infringing their intellectual property rights, and we could suffer significant litigation or licensing expenses or be prevented from selling products.***

As we introduce any new and potentially promising product, companies possessing competing technologies may be motivated to assert infringement claims in order to delay or diminish potential sales and challenge our right to market such product. In addition, we may find it necessary to initiate litigation in order to protect our patent or other intellectual property rights, and such intellectual property litigation is typically costly and time-consuming. Third parties could also obtain patents that may require us to either redesign products or, if possible, negotiate licenses from such third parties. Adverse determinations in any such litigation could result in significant liabilities to third parties or injunctions, or could require us to seek licenses from third parties, and if such licenses are not available on commercially reasonable terms, prevent us from manufacturing, selling or using certain products, any one of which could have a material adverse effect on us. In addition, some licenses may be non-exclusive, which could provide our competitors access to the same technologies. Under any of these circumstances, we may incur significant expenses.

***Our ongoing success is dependent upon the continued availability of certain key employees.***

We are dependent in our operations on the continued availability of the services of our employees, many of whom are individually key to our current and future success, and the availability of new employees to implement our growth plans. In particular, we are dependent upon the services of Deepak Chopra, our Chairman of the Board of Directors, President and Chief Executive Officer. The market for skilled employees is highly competitive, especially for employees in technical fields. While our compensation programs are intended to attract and retain the employees required for us to be successful, ultimately, we may not be able to retain the services of all of our key employees or a sufficient number to execute on our plans. In addition, we may not be able to continue to attract new employees as required.

***Future legislation or regulatory changes to the healthcare system may affect our ability to sell our products profitably.***

There have been, and we expect there will continue to be, a number of legislative and regulatory proposals to change the healthcare system, and some could involve changes that could significantly affect our business. This legislation will significantly affect the ways in which doctors, hospitals, healthcare systems and health insurance companies are compensated for the services they provide. For example, the 2010 health care reform includes a 2.3% excise tax on United States sales of a wide range of medical devices. The excise tax will become effective in 2013. We expect the excise tax to increase our costs. Although some provisions of the health reform legislation have been implemented, many of the legislative changes contained within the health reform legislation will not be effective or implemented until later this year. It is not clear at this time whether and to what extent this legislation may impact the ability of hospitals and hospital networks to purchase the patient monitoring, diagnostic cardiology and anesthesia systems that we sell or if it will alter market-based incentives that hospitals and hospital networks currently face to continually improve, upgrade and expand their use of such equipment. While this legislation could adversely affect us, at this time we cannot predict the extent of any impact on our business or results of operations.

Apart from the 2010 health reform law, efforts by governmental and third- party payers to reduce healthcare costs or the announcement of legislative proposals or reforms to implement government controls could cause a reduction in sales or in the selling price of our products, which could adversely affect our business.

***Substantial government regulation in the United States and abroad may restrict our ability to sell our patient monitoring, diagnostic cardiology and anesthesia systems.***

The FDA and comparable regulatory authorities in foreign countries extensively and rigorously regulate our patient monitoring, diagnostic cardiology and anesthesia systems, including related development activities and manufacturing processes. In the United States, the FDA regulates the introduction of medical devices as well as the manufacturing, labeling and record-keeping procedures for such products. We are required to:

- obtain clearance before we can market and sell medical devices;
- satisfy content requirements applicable to our labeling, sales and promotional materials;
- comply with manufacturing and reporting requirements; and
- undergo rigorous inspections.

Our future products may not obtain FDA clearance on a timely basis, or at all. Our patient monitoring, diagnostic cardiology and anesthesia systems must also comply with the laws and regulations of foreign countries in which we develop, manufacture and market such products. In general, the extent and complexity of medical device regulation is increasing worldwide. This trend is likely to continue and the cost and time required to obtain marketing clearance in any given country may increase as a result. Our products may not obtain any necessary foreign clearances on a timely basis, or at all.

Once any of our patient monitoring, diagnostic cardiology and anesthesia systems is cleared for sale, regulatory authorities may still limit the use of such product, prevent its sale or manufacture or require a recall or withdrawal of such product from the marketplace. Following initial clearance from regulatory authorities, we continue to be subject to extensive regulatory requirements. Government authorities can withdraw marketing clearance due to our failure to comply with regulatory standards or due to the occurrence of unforeseen problems following initial clearance. Ongoing regulatory requirements are wide-ranging and govern, among other things:

- annual inspections to retain a CE mark for sale of products in the European Union;
- product manufacturing;
- supplier substitution;
- product changes;
- process modifications;
- medical device reporting; and
- product sales and distribution.

***Consolidation in the healthcare industry could have an adverse effect on our revenues and results of operations.***

The healthcare industry has been consolidating and organizations such as group purchasing organizations, independent delivery networks, and large single accounts such as the United States Veterans Administration, continue to consolidate purchasing decisions for many of our healthcare provider customers. As a result, transactions with customers are larger, more complex, and tend to involve more long-term contracts. The purchasing power of these larger customers has increased, and may continue to increase, causing downward pressure on product pricing. If we are not one of the providers selected by one of these organizations, we may be precluded from making sales to its members or participants. Even if we are one of the selected providers, we may be at a disadvantage relative to other selected providers that are able to offer volume discounts based on purchases of a broader range of products. Further, we may be required to commit to pricing that has a material adverse effect on our revenues and profit margins, business, financial condition and results of operations. We expect that market demand, governmental regulation, third-party reimbursement policies and societal pressures will continue to change the worldwide healthcare industry, resulting in further business consolidations and alliances, which may exert further downward pressure on the prices of our products and could adversely impact our business, financial condition, and results of operations.

***Technological advances and evolving industry standards could reduce our future product sales, which could cause our revenues to grow more slowly or decline.***

The markets for our products are characterized by rapidly changing technology, changing customer needs, evolving industry standards and frequent new product introductions and enhancements. The emergence of new industry standards in related fields may adversely affect the demand for our products. This could happen, for example, if new standards and technologies emerged that were incompatible with customer deployments of our applications. In addition, any products or processes that we develop may become obsolete or uneconomical before we recover any of the expenses incurred in connection with their development. We cannot assure you that we will succeed in developing and marketing product enhancements or new products that respond to technological change, new industry standards, changed customer requirements or competitive products on a timely and cost-effective basis. Additionally, even if we are able to develop new products and product enhancements, we cannot assure you that they will achieve market acceptance.

***We are subject to various environmental regulations which may impose liability on us whether or not we knew of or caused the release of hazardous substances on or in our facilities.***

We are subject to various foreign and U.S. federal, state and local environmental laws, ordinances and regulations relating to the use, storage, handling and disposal of certain hazardous substances and wastes used or generated in the manufacturing and assembly of our products. Under such laws, we may become liable for the costs of removal or remediation of certain hazardous substances or wastes that have been or are being disposed of offsite

as wastes or that have been or are being released on or in our facilities. Such laws may impose liability without regard to whether we knew of or caused the release of such hazardous substances or wastes. For example, we continue to assess the risks related to U.S. federal, state and local environmental laws related to the soil and groundwater contamination at our Hawthorne, California facility. Any failure by us to comply with present or future regulations could subject us to the imposition of substantial fines, suspension of production, alteration of manufacturing processes, or cessation of operations, any of which could have a material adverse effect on our business, financial condition and results of operations.

***A failure of a key information technology system, process or site could have a material adverse impact on our ability to conduct business.***

We rely extensively on information technology systems to interact with our employees and our customers. These interactions include, but are not limited to, ordering and managing materials from suppliers, converting materials to finished products, shipping product to customers, processing transactions, summarizing and reporting results of operations, complying with regulatory, legal and tax requirements, and other processes necessary to manage our business. If our systems are damaged or cease to function properly due to any number of causes, ranging from the failures of third-party service providers, to catastrophic events, to power outages, to security breaches, and our business continuity plans do not effectively compensate on a timely basis, we may suffer interruptions in our ability to manage operations which may adversely impact our results of operations and/or financial condition.

***Our business and financial results could be negatively affected by cyber or other security threats.***

Information technology is a critically important part of our business operations. Therefore, we may be exposed to cyber and other security threats, including computer viruses, attacks by hackers or physical break-ins. Any electronic or physical break-in or other security breach or compromise may jeopardize security of information stored or transmitted through our information technology systems and networks. This could lead to unauthorized release of confidential or otherwise protected information and corruption of data. Although we have implemented policies, procedures and controls to protect against, detect and mitigate these threats, attempts by others to gain unauthorized access to our information technology systems are becoming more sophisticated. Because of the evolving nature of these security threats, there can be no assurance that our policies, procedures and controls have or will detect or prevent any of these threats and we cannot predict the full impact of any such incident. Occurrence of any of these security threats could adversely affect our business operations and financial results.

***We receive significant amounts of research and development funding for our security and inspection systems from government grants and contracts, but we may not continue to receive comparable levels of funding in the future.***

The U.S. government currently plays an important role in funding the development of certain of our security and inspection systems and sponsoring their deployment at airports, ports, military installations and border crossings. However, in the future, additional research and development funds from the government may not be available to us. If the government fails to continue to sponsor our technologies, we may have to expend more resources on product development or cease development of certain technologies, which could adversely affect our business. In addition, any future grants to our competitors may improve their ability to develop and market competing products and cause our customers to delay purchase decisions, which could harm our ability to market our products.

***Our credit facility contains provisions that could restrict our ability to finance our future operations or engage in other business activities that may be in our interest.***

Our credit facility contains a number of significant covenants that, among other things, limit our ability to:

- dispose of assets;
- incur certain additional indebtedness;
- repay certain indebtedness;

- create liens on assets;
- pay dividends on our Common Stock;
- make certain investments, loans and advances;
- repurchase or redeem capital stock;
- make certain capital expenditures;
- engage in acquisitions, mergers or consolidations; and
- engage in certain transactions with subsidiaries and affiliates.

These covenants could limit our ability to plan for or react to market conditions, finance our operations, engage in strategic acquisitions or disposals or meet our capital needs or could otherwise restrict our activities or business plans. Our ability to comply with these covenants may be affected by events beyond our control. In addition, our credit facility also requires us to maintain compliance with certain financial ratios. Our inability to comply with the required financial ratios or covenants could result in an event of default under our credit facility. A default, if not cured or waived, may permit acceleration of our indebtedness. In addition, our lenders could terminate their commitments to make further extensions of credit under our credit facility. If our indebtedness is accelerated, we cannot be certain that we will have sufficient funds to pay the accelerated indebtedness or that we will have the ability to refinance accelerated indebtedness on terms favorable to us or at all.

***Changes in our tax rates could affect our future financial results.***

Our future effective tax rates could be favorably or unfavorably affected by changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws or their interpretation. In addition, we are subject to the examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these examinations will not have an adverse effect on our operating results and financial condition.

In March 2010, significant reforms to the healthcare system were adopted as law in the United States. The law requires the medical device industry to subsidize healthcare reform in the form of an excise tax on United States sales of most medical devices beginning in 2013. The excise tax will increase the Company's operating expenses. While the new law could reduce medical procedure volumes, lower reimbursement for the Company's products, and impact the demand for the Company's products or the prices at which the Company sells its products, at this time we cannot predict the extent of any impact on our business or results of operations.

***Our Certificate of Incorporation and other agreements contain provisions that could discourage a takeover.***

Our Certificate of Incorporation authorizes our Board of Directors to issue up to 10,000,000 shares of Preferred Stock in one or more series, to fix the rights, preferences, privileges and restrictions granted to or imposed upon any wholly unissued shares of Preferred Stock, to fix the number of shares constituting any such series and to fix the designation of any such series, without further vote or action by stockholders. The terms of any series of Preferred Stock, which may include economic rights senior to our Common Stock and special voting rights, could adversely affect the rights of the holders of our Common Stock and thereby reduce the value of our Common Stock. The issuance of Preferred Stock, coupled with the concentration of ownership in the directors and executive officers, could discourage certain types of transactions involving an actual or potential change in control of our company, including transactions in which the holders of Common Stock might otherwise receive a premium for their shares over then current prices, could otherwise dilute the rights of holders of Common Stock and may limit the ability of such stockholders to cause or approve transactions which they may deem to be in their best interests, all of which could have a material adverse effect on the market price of our Common Stock.

*Our Certificate of Incorporation limits the liability of our directors, which may limit the remedies we or our stockholders have available.*

Our Certificate of Incorporation provides that, pursuant to the Delaware General Corporation Law, the liability of our directors for monetary damages shall be eliminated to the fullest extent permissible under Delaware law, as that law exists currently and as it may be amended in the future. This is intended to eliminate the personal liability of a director for monetary damages in an action brought by us, or in our right for breach of a director's duties to us or our stockholders and may limit the remedies available to us or our stockholders. Under Delaware law, this provision does not apply to eliminate or limit a director's monetary liabilities for: (i) breaches of the director's duty of loyalty to us or our stockholders; (ii) acts or omissions not in good faith or which involve intentional misconduct or knowing violations of law; (iii) the unlawful payment of dividends or unlawful stock repurchases or redemptions under Section 174 of the Delaware General Corporation Law or (iv) transactions in which the director received an improper personal benefit. Additionally, under Delaware law, this provision does not limit a director's liability for the violation of, or otherwise relieve us or our directors from complying with, federal or state securities laws, nor does it limit the availability of non-monetary remedies such as injunctive relief or rescission for a violation of federal or state securities laws.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds** — See Share Repurchase Program discussion under Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Item 3. Defaults Upon Senior Securities** — None

**Item 4. Mine Safety Disclosures** — None

**Item 5. Other Information** — None

**Item 6 . Exhibits**

31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document ‡
101.SCH	XBRL Taxonomy Extension Schema Document‡
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document‡
101.DEF	XBRL Extension Definition‡
101.LAB	XBRL Taxonomy Extension Label Linkbase Document‡
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document‡

---

‡ XBRL information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended, and is not subject to liability under those sections, is not part of any registration statement or prospectus to which it relates and is not incorporated or deemed to be incorporated by reference into any registration statement, prospectus or other document.

**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 8th day of May 2013.

**OSI SYSTEMS, INC.**

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

By: /s/ Alan Edrick  
Alan Edrick  
Executive Vice President and Chief Financial Officer

**CERTIFICATION**

Certification required by Rule 13a-14(a) or Rule 15d-14(a)  
and under Section 302 of the Sarbanes-Oxley Act of 2002

I, Deepak Chopra, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of OSI Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 8, 2013

/s/ Deepak Chopra  
Deepak Chopra  
Chief Executive Officer

---

**CERTIFICATION**

Certification required by Rule 13a-14(a) or Rule 15d-14(a)  
and under Section 302 of the Sarbanes-Oxley Act of 2002

I, Alan Edrick, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of OSI Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 8, 2013

/s/ Alan Edrick  
Alan Edrick  
Chief Financial Officer

---

**CERTIFICATION**

Certification of Chief Executive Officer  
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350

In connection with the Quarterly Report of OSI Systems, Inc. (the "Company") on Form 10-Q for the quarter ended March 31, 2013 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Deepak Chopra, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company at the dates and for the periods presented in this Report.

Date: May 8, 2013

/s/ Deepak Chopra  
Deepak Chopra  
Chief Executive Officer

The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350, is not being filed as part of the Report or as a separate disclosure document, and is not being incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, (whether made before or after the date of the Report) irrespective of any general incorporation language contained in such filing. The signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

---

**CERTIFICATION**

Certification of Chief Financial Officer  
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350

In connection with the Quarterly Report of OSI Systems, Inc. (the "Company") on Form 10-Q for the quarter ended March 31, 2013 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Alan Edrick, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company at the dates and for the periods presented in this Report.

Date: May 8, 2013

/s/ Alan Edrick

Alan Edrick  
Chief Financial Officer

The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350, is not being filed as part of the Report or as a separate disclosure document, and is not being incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, (whether made before or after the date of the Report) irrespective of any general incorporation language contained in such filing. The signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

---