

# OSI SYSTEMS INC

## FORM 10-Q (Quarterly Report)

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Address	12525 CHADRON AVE HAWTHORNE, CA 90250
Telephone	3109780516
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Industry	Scientific & Technical Instr.
Sector	Technology
Fiscal Year	06/30

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

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**FORM 10-Q**

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(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, 2014

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

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**OSI SYSTEMS, INC.**

(Exact name of registrant as specified in its charter)

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**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)

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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 1, 2014, there were 19,941,974 shares of the registrant's common stock outstanding.

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## OSI SYSTEMS, INC.

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## 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, 2013	March 31, 2014
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 34,697	\$ 39,848
Accounts receivable, net	206,817	142,806
Inventories	206,213	239,026
Prepaid expenses and other current assets	78,972	93,932
Total current assets	526,699	515,612
Property and equipment, net	249,029	265,739
Goodwill	83,743	92,196
Intangible assets, net	36,603	40,725
Other assets	23,722	25,475
Total assets	<u>\$ 919,796</u>	<u>\$ 939,747</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Bank lines of credit	\$ 59,000	\$ 22,000
Current portion of long-term debt	1,797	2,779
Accounts payable	97,050	73,808
Accrued payroll and related expenses	28,503	31,869
Advances from customers	37,432	39,864
Accrued warranties	12,890	11,356
Deferred revenue	18,131	62,940
Other accrued expenses and current liabilities	26,610	21,635
Total current liabilities	281,413	266,251
Long-term debt	10,673	10,847
Advances from customers	75,000	56,250
Deferred income taxes	30,248	57,163
Other long-term liabilities	44,011	47,489
Total liabilities	441,345	438,000
Commitments and contingencies (Note 8)		
Stockholders' Equity:		
Preferred stock, \$0.001 par value, 10,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, \$0.001 par value, 100,000,000 shares authorized; 19,914,089 issued and outstanding at June 30, 2013 and 19,938,859 shares at March 31, 2014	285,001	279,994
Retained earnings	199,786	225,554
Accumulated other comprehensive loss	(6,336)	(3,801)
Total stockholders' equity	478,451	501,747
Total liabilities and stockholders' equity	<u>\$ 919,796</u>	<u>\$ 939,747</u>

See accompanying notes to condensed consolidated financial statements.

**OSI SYSTEMS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except per share data)  
(Unaudited)

	For the Three Months Ended March 31,		For the Nine Months Ended March 31,	
	2013	2014	2013	2014
<b>Net revenues:</b>				
Products	\$ 139,026	\$ 139,411	\$ 432,976	\$ 456,861
Services	59,383	64,545	141,176	189,777
Total net revenues	198,409	203,956	574,152	646,638
<b>Cost of goods sold:</b>				
Products	96,156	95,620	288,988	317,994
Services	30,415	37,829	81,883	109,252
Total cost of goods sold	126,571	133,449	370,871	427,246
Gross profit	71,838	70,507	203,281	219,392
<b>Operating expenses:</b>				
Selling, general and administrative	37,752	39,399	114,506	127,169
Research and development	12,386	10,579	35,560	32,774
Impairment, restructuring and other charges	2,286	2,507	5,009	8,925
Total operating expenses	52,424	52,485	155,075	168,868
Income from operations	19,414	18,022	48,206	50,524
Interest and other expense, net	1,341	1,370	3,823	4,343
Income before income taxes	18,073	16,652	44,383	46,181
Provision for income taxes	4,544	11,851	12,094	20,413
Net income	<u>\$ 13,529</u>	<u>\$ 4,801</u>	<u>\$ 32,289</u>	<u>\$ 25,768</u>
<b>Net income per share:</b>				
Basic	<u>\$ 0.68</u>	<u>\$ 0.24</u>	<u>\$ 1.62</u>	<u>\$ 1.29</u>
Diluted	<u>\$ 0.66</u>	<u>\$ 0.23</u>	<u>\$ 1.57</u>	<u>\$ 1.25</u>
<b>Shares used in per share calculation:</b>				
Basic	<u>19,987</u>	<u>19,936</u>	<u>19,964</u>	<u>19,956</u>
Diluted	<u>20,555</u>	<u>20,548</u>	<u>20,578</u>	<u>20,585</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,	
	2013	2014	2013	2014
Net income	\$ 13,529	\$ 4,801	\$ 32,289	\$ 25,768
Other comprehensive income (loss):				
Foreign currency translation adjustment	(7,709)	247	(2,970)	2,026
Other	250	387	(89)	509
Other comprehensive income (loss)	(7,459)	634	(3,059)	2,535
Comprehensive income	<u>\$ 6,070</u>	<u>\$ 5,435</u>	<u>\$ 29,230</u>	<u>\$ 28,303</u>

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,	
	2013	2014
<b>Cash flows from operating activities:</b>		
Net income	\$ 32,289	\$ 25,768
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	17,872	40,024
Stock based compensation expense	11,482	13,975
Provision for losses on accounts receivable	2,508	604
Deferred income taxes	196	25,769
Other	238	196
Changes in operating assets and liabilities —net of business acquisitions :		
Accounts receivable	(15,181)	68,345
Inventories	(4,745)	(28,640)
Prepaid expenses and other assets	14,819	(22,211)
Accounts payable	25,283	(26,680)
Accrued payroll and related expenses	1,035	3,081
Advances from customers	(9,382)	(16,321)
Accrued warranties	(3,538)	(1,918)
Deferred revenue	(5,471)	43,363
Other accrued expenses and liabilities	(10,158)	(1,529)
Net cash provided by operating activities	<u>57,247</u>	<u>123,826</u>
<b>Cash flows from investing activities:</b>		
Acquisition of property and equipment	(139,429)	(48,133)
Acquisition of businesses	(6,087)	(11,640)
Acquisition of intangible and other assets	(3,773)	(4,213)
Net cash used in investing activities	<u>(149,289)</u>	<u>(63,986)</u>
<b>Cash flows from financing activities:</b>		
Net borrowings (repayments) on bank lines of credit	55,000	(37,000)
Proceeds from long-term debt	11,100	3,220
Payments on long-term debt	(824)	(2,952)
Proceeds from exercise of stock options and employee stock purchase plan	4,615	1,501
Repurchase of common shares	(10,444)	(12,056)
Taxes paid related to net share settlements of equity awards	(10,301)	(8,427)
Net cash provided by (used in) financing activities	<u>49,146</u>	<u>(55,714)</u>
Effect of exchange rate changes on cash	(876)	1,025
Net increase (decrease) in cash and cash equivalents	(43,772)	5,151
Cash and cash equivalents-beginning of period	91,452	34,697
Cash and cash equivalents-end of period	<u>\$ 47,680</u>	<u>\$ 39,848</u>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid, net during the period for:		
Interest	<u>\$ 2,256</u>	<u>\$ 3,846</u>
Income taxes	<u>\$ 9,679</u>	<u>\$ 15,000</u>

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 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 reporting segments: (i) Security, providing security 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 manufacturing clients for applications in the defense, aerospace, medical and industrial markets, among others.

Through its Security division, the Company designs, manufactures and markets security inspections systems and security screening, threat detection and non-intrusive inspection products and related services globally. These products fall into the following categories: baggage and parcel inspection systems; cargo and vehicle inspection systems; hold (checked) baggage screening systems; people screening systems and radiation detection systems. In addition to these products, the Company provides site design, installation, training and technical support services to its customers. The Company also provides turnkey security screening solutions, which can include the construction, staffing and long term operation of security screening checkpoints for its customers.

Through its Healthcare division, the Company designs, manufactures and markets patient monitoring, diagnostic cardiology and anesthesia delivery and ventilation systems, and related services worldwide. 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 worldwide 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 consumer products. 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 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. The condensed consolidated financial statements have been prepared by the Company, without audit, pursuant to interim financial reporting guidelines. 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 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 for the periods presented. These 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, 2013. The results of operations for the three and nine months ended March 31, 2014 are not necessarily indicative of the operating results to be expected for the full 2014 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 outstanding. Potential common shares consist of the shares issuable upon the exercise of stock options and restricted stock awards or units under the treasury stock method. Stock awards to purchase 0.1 million shares of common stock for the three and nine months ended March 31, 2014 were excluded from the calculation of diluted earnings per share because to do so would have been antidilutive; while during the three and nine months ended March 31, 2013 no stock awards were excluded from the calculation.

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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,	
	2013	2014	2013	2014
Net income available to common stockholders	\$ 13,529	\$ 4,801	\$ 32,289	\$ 25,768
Weighted average shares outstanding for basic earnings per share calculation	19,987	19,936	19,964	19,956
Dilutive effect of stock awards	568	612	614	629
Weighted average shares outstanding for diluted earnings per share calculation	20,555	20,548	20,578	20,585
Basic net income per share	\$ 0.68	\$ 0.24	\$ 1.62	\$ 1.29
Diluted net income per share	\$ 0.66	\$ 0.23	\$ 1.57	\$ 1.25

### 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.

### 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 long-term 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 rates offered 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. "Level 1" category includes assets and liabilities at the quoted prices in active markets for identical assets and liabilities. "Level 2" category includes assets and liabilities from observable inputs other than quoted market prices. "Level 3" category includes assets and liabilities whose valuation techniques are unobservable and significant to the fair value measurement. 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 following is a summary of the investments carried at fair value (in thousands):

	June 30,		June 30,		March 31,	
	Level 1	Level 2	2013	Level 1	Level 2	2014
Equity securities	316	—	316	555	—	555
Insurance company contracts	—	13,914	13,914	—	16,716	16,716
Interest rate contract	—	66	66	—	58	58
Total	\$ 316	\$ 13,980	\$ 14,296	\$ 555	\$ 16,774	\$ 17,329

### Derivative Instruments and Hedging Activity

The Company's use of derivatives consists of an interest rate swap agreement. The interest rate swap agreement was entered into to improve the predictability of cash flows from interest payments related to variable, LIBOR-based debt for the duration of the term loan. The interest rate swap matures in October 2019. The interest rate swap 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 income when the hedge transaction settles.

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### 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 turnkey services agreements is included in revenue from services. In certain agreements, revenue 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. On occasion, the Company receives advances from customers that are amortized against future customer payments pursuant to the underlying agreements. Such advances are classified in the condensed consolidated balance sheets as either a current or long term liability dependent upon when the Company estimates the corresponding amortization to occur.

### 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. During the nine months ended March 31, 2014, the Company completed acquisitions that were immaterial both individually and in the aggregate.

### Reclassifications

We have reclassified certain prior period amounts within our condensed consolidated financial statements to conform to our current year presentation.

## 2. Balance Sheet Details

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

	<u>June 30, 2013</u>	<u>March 31, 2014</u>
<b>Accounts receivable</b>		
Billed receivables	\$ 179,458	\$ 146,622
Unbilled receivables	34,636	2,664
Less allowance for doubtful accounts	(7,277)	(6,480)
Total	<u>\$ 206,817</u>	<u>\$ 142,806</u>

Unbilled receivables included earned but unbilled revenue.

	<u>June 30, 2013</u>	<u>March 31, 2014</u>
<b>Inventories</b>		
Raw materials	\$ 117,416	\$ 122,633
Work-in-process	37,337	53,014
Finished goods	51,460	63,379
Total	<u>\$ 206,213</u>	<u>\$ 239,026</u>

	<u>June 30, 2013</u>	<u>March 31, 2014</u>
<b>Property and equipment</b>		
Land	\$ 8,365	\$ 13,651
Buildings and improvements	102,187	161,310
Leasehold improvements	9,302	10,311
Equipment and tooling	135,437	154,799
Furniture and fixtures	3,551	4,103
Computer equipment	14,309	16,970
Computer software	15,209	15,416
Construction in process	<u>48,713</u>	<u>11,996</u>

Total	337,073	388,556
Less: accumulated depreciation and amortization	(88,044)	(122,817)
Property and equipment, net	<u>\$ 249,029</u>	<u>\$ 265,739</u>

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Depreciation expense was approximately \$14.4 million and \$36.5 million for the nine months ended March 31, 2013 and 2014, respectively, and approximately \$5.8 million and \$12.6 million for the three months ended March 31, 2013 and 2014, respectively.

### 3. Goodwill and Intangible Assets

The changes in the carrying value of goodwill for the nine month period ended March 31, 2014 are as follows (in thousands):

	Security	Healthcare	Optoelectronics and Manufacturing	Consolidated
Balance as of June 30, 2013	\$ 28,546	\$ 35,827	\$ 19,370	\$ 83,743
Goodwill acquired or adjusted during the period	784	1,018	5,531	7,333
Foreign currency translation adjustment	222	299	599	1,120
Balance as of March 31, 2014	<u>\$ 29,552</u>	<u>\$ 37,144</u>	<u>\$ 25,500</u>	<u>\$ 92,196</u>

Intangible assets consisted of the following (in thousands):

	Weighted Average Lives	June 30, 2013			March 31, 2014		
		Gross Carrying Value	Accumulated Amortization	Intangibles Net	Gross Carrying Value	Accumulated Amortization	Intangibles Net
Amortizable assets:							
Software development costs	7 years	\$ 17,350	\$ 5,396	\$ 11,954	\$ 19,764	\$ 6,473	\$ 13,291
Patents	13 years	5,400	635	4,765	6,320	732	5,588
Core technology	10 years	2,058	1,728	330	2,235	2,043	192
Developed technology	11 years	20,002	14,620	5,382	16,360	11,347	5,013
Customer relationships/backlog	7 years	9,178	5,624	3,554	11,370	6,718	4,652
Total amortizable assets		<u>53,988</u>	<u>28,003</u>	<u>25,985</u>	<u>56,049</u>	<u>27,313</u>	<u>28,736</u>
Non-amortizable assets - Trademarks		10,618	—	10,618	11,989	—	11,989
Total intangible assets		<u>\$ 64,606</u>	<u>\$ 28,003</u>	<u>\$ 36,603</u>	<u>\$ 68,038</u>	<u>\$ 27,313</u>	<u>\$ 40,725</u>

Amortization expense related to intangibles assets was \$3.5 million for each of the nine months ended March 31, 2013 and 2014, respectively. For the three months ended March 31, 2013 and 2014, amortization expense was \$1.2 million and \$1.0 million, respectively. At March 31, 2014, the estimated future amortization expense was as follows (in thousands):

Fiscal Years	
2014 (remaining 3 months)	\$ 820
2015	2,911
2016	3,150
2017	2,782
2018	2,633
2019	2,532
2020 and thereafter, including assets that have not yet begun to be amortized	<u>13,908</u>
Total	<u>\$ 28,736</u>

Software development costs for software products incurred before establishing technological feasibility are charged to operations. Software development costs incurred after establishing technological feasibility are capitalized on a product by product basis until the product is available for general release to customers at which time amortization begins. Annual amortization, charged to cost of goods sold, is the amount computed using the ratio that current revenues for a product bear to the total current and anticipated future revenues for that product. In the event that future revenues are not estimable, such costs are amortized on a straight line basis over the remaining estimated economic life of the product. Amortizable assets that have not yet begun to be amortized are included in thereafter in the table above. The Company capitalized software development costs in the amount of \$2.9 million and \$2.2 million for the nine months ended March 31, 2013 and 2014, respectively, and \$1.2 million and \$0.5 million for each of the three months ended March 31, 2013 and 2014, respectively.

#### 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, 2014. 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 and warranties, affirmative and negative and financial covenants, and events of default customary for financing agreements of this type. As of March 31, 2014, there was \$22.0 million outstanding under the revolving credit facility and \$112.0 million outstanding under the letters-of-credit sub-facility.

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, 2014, \$5.8 million was outstanding under these letter-of-credit facilities, while no debt was outstanding. As of March 31, 2014, the total amount available under these credit facilities was \$35.8 million, with a total cash borrowing sub-limit of \$3.2 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, which bears interest at LIBOR plus 1.25%, is payable on a monthly basis over seven years. 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.

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

	June 30, 2013	March 31, 2014
Term loans	\$ 12,470	\$ 11,316
Other long-term debt	—	2,310
	<u>12,470</u>	<u>13,626</u>
Less current portion of long-term debt	1,797	2,779
Long-term portion of debt	<u>\$ 10,673</u>	<u>\$ 10,847</u>

#### 5. Impairment, Restructuring and Other Charges

The following table summarizes the impairment, restructuring and other charges (in thousands):

	Security Division	Healthcare Division	Optoelectronics and Manufacturing Division	Corporate	Consolidated
Balance as of June 30, 2013	\$ 1,043	\$ 1,639	\$ 66	—	\$ 2,748
Expensed during the period:					
Facility closures (1)	—	2,009	763	—	2,772
Employee termination costs (2)	822	—	669	—	1,491
Charges related to government contract issues (3)	4,298	—	—	—	4,298
Charges related to class action litigation	—	—	—	364	364
Total expensed during the period	<u>5,120</u>	<u>2,009</u>	<u>1,432</u>	<u>364</u>	<u>8,925</u>
Paid or incurred during the period	4,546	2,046	1,215	364	8,171
Balance as of March 31, 2014	<u>\$ 1,617</u>	<u>\$ 1,602</u>	<u>\$ 283</u>	<u>—</u>	<u>\$ 3,502</u>

- (1) The facility relocation within the Healthcare division began in fiscal 2013 and was completed during the first quarter of fiscal 2014. The facility consolidations within the Optoelectronics and Manufacturing division began during the first quarter of fiscal 2014 and are expected to be completed during the remainder of the year.
- (2) The employee termination costs within the Security division were incurred as a result of management restructuring. The employee termination costs within the Optoelectronics and Manufacturing division related to facility consolidations that began in the first quarter of fiscal 2014 and are expected to be completed during the remainder of the fiscal year.
- (3) These costs related to a contract with the Transportation Security Administration (TSA) terminated in fiscal 2013 and current contract issues with the TSA and other U.S. government agencies. These costs include removal, storage and refurbishing costs for products previously sold to the TSA as required by the termination, and legal and other costs for the current contract issues.

## 6. Stock-based Compensation

As of March 31, 2014, the Company maintained two share-based employee compensation plans (the “OSI Plans”): the 2012 Incentive Award Plan (“2012 Plan”) and the 2006 Equity Participation Plan (“2006 Plan”). Upon the effective date of the 2012 Plan, the Company ceased to make grants under the 2006 Plan.

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2013	2014	2013	2014
Cost of goods sold	\$ 335	\$ 180	\$ 601	\$ 705
Selling, general and administrative	3,944	3,057	10,709	13,130
Research and development	57	17	172	140
Stock-based compensation expense before taxes	\$ 4,336	\$ 3,254	11,482	\$ 13,975
Less: related income tax benefit	1,656	1,319	4,364	5,457
Stock-based compensation expense, net of estimated taxes	\$ 2,680	\$ 1,935	\$ 7,118	\$ 8,518

As of March 31, 2014, total unrecognized compensation cost related to share-based compensation grants were estimated at \$1.3 million for stock options and \$18.7 million for restricted stock and restricted stock units (“RSUs”) under the OSI Plans. The Company expects to recognize these costs over a weighted-average period of 1.6 years with respect to the options and 2.0 years for grants of restricted stock and RSUs.

The following summarizes stock option activity during the nine months ended March 31, 2014:

	Number of Options	Weighted- Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)
Outstanding at June 30, 2013	1,019,733	\$ 26.33		
Granted	10,294	\$ 70.59		
Exercised	(1,169)	\$ 39.97		
Expired or forfeited	(4,646)	\$ 54.07		
Outstanding at March 31, 2014	1,024,212	\$ 26.63	5.9 years	\$ 34,144
Exercisable at March 31, 2014	845,805	\$ 22.55	5.4 years	\$ 31,537

A summary of restricted stock and RSU award activity during the nine months ended March 31, 2014 is as follows:

	Shares	Weighted- Average Fair Value
Nonvested at June 30, 2013	627,124	\$ 43.19
Granted	322,275	63.73
Vested	(276,716)	39.16
Forfeited	(3,992)	49.23
Nonvested at March 31, 2014	668,691	\$ 54.73

As of March 31, 2014, there were 3,322,921 shares available for grant under the 2012 Plan. Under the terms of that plan, restricted stock and RSUs 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. Restricted stock and RSUs forfeited and returned to the pool of shares available for grant increase the pool by 1.87 shares for each share forfeited.

The Company granted 178,500 and 160,922 performance-based awards during the nine months ended March 31, 2013 and 2014 respectively. These performance-based restricted stock and RSU awards are contingent on the achievement of certain financial performance metrics. The payout can range from zero to 250% of the original number of shares or units awarded, which are converted into shares of the Company’s common stock.



## 7. 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,	
	2013	2014	2013	2014
Service cost	\$ 269	\$ 288	\$ 853	\$ 890
Amortization of prior service cost	229	202	689	606
Net periodic pension expense	\$ 498	\$ 490	\$ 1,542	\$ 1,496

For each of the three months ended March 31, 2013 and 2014, the Company made contributions of \$0.1 million to these defined benefit plans. For the nine months ended March 31, 2013 and 2014, the Company made contributions of \$0.1 million and \$1.0 million, respectively, to these defined benefit plans.

In addition, the Company maintains various defined contribution plans. For the three months ended March 31, 2013 and 2014, the Company made contributions of \$0.9 and \$1.0 million, respectively, to these defined contribution plans. For the nine months ended March 31, 2013 and 2014, the Company made contributions of \$2.7 million and \$3.0 million, respectively, to these defined contribution plans.

## 8. Commitments and Contingencies

### *Legal Proceedings*

On December 12, 2013, a putative class action complaint was filed against the Company and certain of its officers in the United States District Court for the Central District of California (“Court”), captioned *Roberti v. OSI Systems, Inc., et al.*, Case No. 2:13-cv-09174-MWF-VBK (the “Roberti Action”). The Roberti Action purports to be brought on behalf of persons who purchased the Company’s common stock between January 24, 2012 and December 6, 2013. The complaint generally asserts that defendants violated section 10(b) of the Securities Exchange Act of 1934 (the “Act”) and Rule 10b-5 promulgated thereunder and also that the individual defendants violated section 20(a) of the Act by misrepresenting or failing to disclose that the Company allegedly manipulated operational testing of its Advanced Imaging Technology by selectively picking the best sensors and thereby causing the testing not to be representative of the scanners already deployed at airports; that certain of the Company’s products allegedly raised strong privacy concerns and were subject to disqualification for use in airport security checkpoints; and that the Company allegedly manufactured its products with parts that violated contracts with TSA, thereby risking cancellation of the contracts. Plaintiffs demand a jury trial and seek class certification, unspecified damages, an award of pre-judgment and post-judgment interest, attorneys’ and experts’ fees, costs, and other unspecified relief. On March 17, 2014, the Court appointed plaintiff Arkansas State Highway Employees Retirement System as lead plaintiff.

On April 15, 2014, a putative shareholder derivative complaint was filed in the Court against the Company (as nominal defendant) and the members of the Company’s Board of Directors (as individual defendants) as a related case to the Roberti Action and was captioned *Hagan v. Chopra, et al.*, Case No. 2:14-cv-02910-ODW-PJW (the “Derivative Action”). The complaint in the Derivative Action generally asserts the same factual allegations as those at issue in the Roberti Action and also claims that certain of the individual defendants allegedly sold stock based on material non-public information. The plaintiff in the Derivative Action asserts that, while he never made any demand on the Board of Directors to take corrective action, demand was purportedly excused. The Derivative Action generally brings claims for breach of fiduciary duties and unjust enrichment, and the complaint seeks unspecified damages, restitution, injunctive relief, attorneys’ and experts’ fees, costs, expenses, and other unspecified relief.

While the Company believes that the Roberti Action and the Derivative Action are without merit and intends to defend the litigation vigorously, it expects to incur costs associated with defending the Roberti Action and the Derivative Action. At this early stage of the litigations, the ultimate outcomes of the Roberti Action and the Derivative Action are uncertain and the Company cannot reasonably assess the timing or outcomes, or estimate the amount of loss, if any, or their effect, if any, on its financial statements.

The Company is involved in various other 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, results of operations or cash flows. 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 or 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, results of operations and/or liquidity 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 by the acquired operations of certain sales or profitability milestones. The maximum amount of such future payments under arrangements with contingent consideration caps is \$51 million as of March 31, 2014. 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 CXR Limited, a company acquired in 2004. For acquisitions that occurred prior to fiscal year 2010, the Company accounts for such contingent payments as an addition to the purchase price of the acquired business. Otherwise, the estimated fair value of these obligations is recorded as a liability at the time of the acquisition in the condensed consolidated balance sheets with subsequent revisions reflected in the condensed consolidated statements of operations. As of June 30, 2013 and March 31, 2014, \$15.4 million and \$18.5 million of contingent payment obligations, respectively, are included in Other long-term liabilities in the accompanying condensed consolidated balance sheets.

*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 amortized. As of March 31, 2014, \$81.3 million of this advance remains outstanding.

*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 that the Company believes was the result of unspecified on- and off-site releases occurring prior to the Company's occupancy. Historical usage of this site includes semiconductor and electronics manufacturing, dating back to the mid-1960's, as well as possible aircraft and related manufacturing dating to the early 1940's. Similar operations, including chemical manufacturing and storage, were conducted at neighboring sites throughout that period and into the 1990's. It is not presently known when the releases occurred or by whom they were caused, though Company records, in conjunction with data obtained from soil and groundwater surveys, support the Company's assertion that these releases are historical in nature. Further, the groundwater contamination is a known regional issue, not limited to the Company's premises or its immediate surroundings. The Company filed the requisite reports concerning this site with the appropriate environmental authorities upon discovery, and in cooperation with the local governing agency has provided additional historical information and conducted further site characterization studies. Recent soil and groundwater investigations, including the installation of groundwater monitoring wells, were completed in fiscal 2014. Results from these studies are being evaluated to determine the extent of the on-site releases and whether any soils remediation will be required. Periodic groundwater monitoring is expected to continue until such time as the governing authority requests further action.

The Company has not accrued for loss contingencies relating to the Hawthorne facility or any other environmental matters because it believes that, although unfavorable outcomes may be possible, they are not considered by the Company's management to be probable and reasonably estimable. If one or more of environmental matters are resolved in a manner adverse to the Company, the impact on the Company's business, financial condition, results of operations, financial position and/or liquidity could be material.

*Indemnifications*

In the normal course of business, the Company has agreed to indemnify certain parties with respect to certain matters. The Company has agreed to hold certain parties harmless against losses arising from a breach of representations, warranties or covenants, or out of intellectual property infringement or other claims made by third parties. These agreements may limit the time within which an indemnification claim can be made and the amount of the claim. In addition, the Company has entered into indemnification agreements with its directors and certain of its officers. It is not possible to determine the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. The Company has not recorded any liability for costs related to indemnification as of March 31, 2014.

*Other Matters*

On December 5, 2013, the Company’s Security division was notified by the TSA that a delivery order that it had received on September 26, 2013, for baggage and handling inspection systems was being terminated for default. The termination resulted from the use of an upgraded X-ray generator component. While the component had been vetted by the Security division’s internal quality assurance, the Security division had not met the contractual requirement of obtaining the TSA’s approval in advance. As a result of this termination for default, the Security division has been referred to the U.S. Department of Homeland Security for further review. Although the results of this review cannot be determined at this time, among other consequences, the Security division could be barred from conducting future business with the U.S. federal government for a period of time.

*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):

	Nine Months Ended March 31,	
	2013	2014
Balance at beginning of period	\$ 17,562	\$ 12,890
Warranty claims provision	1,195	3,306
Settlements made	(4,794)	(4,840)
Balance at end of period	<u>13,963</u>	<u>\$ 11,356</u>

**9. 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 include 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, changes in or the interpretation of tax laws in jurisdictions where the Company conducts business and certain tax elections. During the three months ended March 31, 2014, the Company elected to accelerate depreciation of certain foreign assets. As a result of this election the tax bases of these assets were permanently reduced, which increased the effective tax rate for the three months and nine months ended March 31, 2014 to 71.2% and 44.2%, respectively. Had this election not been made and the assets were depreciated using regular depreciation, the effective tax rate would have been 25.3% and 27.7% for the three and nine months ended March 31, 2014, respectively. Effective for tax years beginning January 1, 2014, the election to accelerate depreciation is no longer available in the Mexican tax code. 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.

## 10. 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-user businesses, while 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, 2013.

The following tables present the operations and identifiable assets by industry segment (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2013	2014	2013	2014
<b>Revenues (2) — by Segment:</b>				
Security division	\$ 99,840	\$ 95,007	\$ 274,619	\$ 298,748
Healthcare division	51,357	52,188	159,052	161,081
Optoelectronics and Manufacturing division, including intersegment revenues	54,761	66,331	169,185	214,000
Intersegment revenues elimination	(7,549)	(9,570)	(28,704)	(27,191)
Total	<u>\$ 198,409</u>	<u>\$ 203,956</u>	<u>\$ 574,152</u>	<u>\$ 646,638</u>
	Three Months Ended March 31,		Nine Months Ended March 31,	
	2013	2014	2013	2014
<b>Operating income (loss) — by Segment:</b>				
Security division	\$ 16,179	\$ 14,213	\$ 29,251	\$ 40,984
Healthcare division	3,593	4,084	14,389	11,312
Optoelectronics and Manufacturing division	3,271	3,414	13,561	10,300
Corporate	(4,017)	(3,488)	(9,704)	(11,888)
Eliminations (1)	388	(201)	709	(184)
Total	<u>\$ 19,414</u>	<u>\$ 18,022</u>	<u>\$ 48,206</u>	<u>\$ 50,524</u>
			June 30, 2013	March 31, 2014
<b>Assets — by Segment:</b>				
Security division			\$ 499,539	\$ 505,334
Healthcare division			190,963	172,136
Optoelectronics and Manufacturing division			158,584	178,421
Corporate			75,496	88,825
Eliminations (1)			(4,786)	(4,969)
Total			<u>\$ 919,796</u>	<u>\$ 939,747</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 profits in inventory as of the balance sheet date. Such intercompany profit will be realized when inventory is shipped to the external customers of the Security and Healthcare divisions.
- (2) One customer accounted for 16% and 15% of total net revenues for the three and nine months ended March 31, 2014, respectively; and the same customer accounted for 14% and 8% of total net revenues for the three and nine months ended March 31, 2013, respectively. No customers accounted for 10% or more of receivables as of March 31, 2014.

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

In this report, "OSI", the "Company", "we", "us", "our" and similar terms refer to OSI Systems, Inc. together with its wholly-owned subsidiaries.

This management's discussion and analysis of financial condition as of March 31, 2014 and results of operations for the nine-months ended March 31, 2013 and 2014 should be read in conjunction with management's discussion and analysis of financial condition and results of operations included in our Annual Report on Form 10-K for the year ended June 30, 2013.

### Forward-Looking Statements

*Certain statements contained in this Quarterly Report on Form 10-Q that are not related to historical results, including, without limitation, statements regarding our business strategy, objectives and future financial position, are 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, and involve risks and uncertainties. These forward-looking statements may be identified by the use of forward-looking terms such as "anticipate," "believe," "expect," "may," "could," "likely to," "should," or "will," or by discussions of strategy that involve predictions which are based upon a number of future conditions that ultimately may prove to be inaccurate. Statements in this Quarterly Report on Form 10-Q that are forward-looking are based on current expectations and actual results may differ materially. These forward-looking statements should be considered in light of numerous risks and uncertainties 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. For example, the Company could be exposed to a variety of negative consequences as a result of delays related to the award of domestic and international contracts; delays in customer programs; unanticipated impacts of sequestration and other provisions of the Budget Control Act of 2011 as modified by the Bipartisan Budget Act of 2013; changes in domestic and foreign government spending, budgetary, procurement and trade policies adverse to our businesses; market acceptance of our new and existing technologies, products and services; our ability to win new business and convert any orders received to sales within the fiscal year in accordance with our annual operating plan; one or more enforcement actions in respect of any noncompliance with laws and regulations including export control and environmental regulations and the matters that are the subject of some or all of the Company's ongoing investigations and compliance review, including contract and regulatory compliance matters with the U.S. Government, and such actions, if brought, resulting in judgments, settlements, fines, injunctions, debarment and/or penalties as well as other risks and uncertainties, including but not limited to those detailed herein and from time to time in our Securities and Exchange Commission filings, which could have a material and adverse impact on the Company's business, financial condition and results of operation. 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.*

### 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 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 46% of our total consolidated revenues for the nine months ended March 31, 2013 and 2014, 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.

Currently, the U.S. federal government is discussing various options to address sequestration and the U.S. federal government's overall fiscal challenges and we cannot predict the outcome of these efforts. While we believe that national security spending will continue to be a priority, U.S. government budget deficits and the national debt have created increasing pressure to examine and reduce spending across many federal agencies. We believe that the diversified product portfolio and international customer mix of our Security division position us well to withstand the impact of these uncertainties and even benefit from specific initiatives within various governments. However, depending on how future sequestration cuts are implemented and how the U.S. federal government manages its fiscal challenges, we believe that these federal actions could have a material, adverse effect on our business, financial condition and results of operations.

On December 5, 2013, we were notified by the U.S. Transportation Security Administration (TSA) that a delivery order that we had received on September 26, 2013, for baggage and handling inspection systems was being terminated for default. The termination resulted from the use of an upgraded X-ray generator component. While the component had been vetted by our Security division's internal quality assurance, we had not met the contractual requirement of obtaining the TSA's approval in advance. As a result of this termination for default, we have been referred to the U.S. Department of Homeland Security (DHS) for further review. Although the results of this review cannot be determined at this time, among other consequences, we could be barred from conducting future business with the U.S. federal government for a period of time. 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 worldwide 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 25% of our total consolidated revenues for the nine months ended March 31, 2013 and 2014, 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. In addition, there is continued uncertainty regarding the ongoing debates related to the U.S. budget and debt ceiling and the Patient Protection and Affordable Care Act, amended by the Health Care and Education and Reconciliation Act of 2010 (the "Affordable Care Act"), in the U.S., any of which may impact hospital spending, reimbursement and fees which will be levied on certain medical device revenues and adversely affect our business and results of operations. In addition, hospital capital spending appears to have been impacted by strategic uncertainties surrounding the Affordable Care Act and economic pressures. 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, sales of our healthcare products may be negatively impacted. Although there are indications that a general economic recovery is underway, we cannot predict when the markets will fully recover or when the uncertainties related to the U.S. federal government will be resolved 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, gaming systems and consumer products. 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 29% of our total consolidated revenues for the nine months ended March 31, 2013 and 2014, respectively.

During the nine months ended March 31, 2014, our Optoelectronics and Manufacturing division completed two acquisitions relating to our contract manufacturing services business and allowed us to expand our customer base and geographic footprint, while leveraging our existing infrastructure. These acquisitions were considered to be immaterial individually and in the aggregate.



**Results of Operations for the Three Months Ended March 31, 2013 (Q3 2013) Compared to Three Months Ended March 31, 2014 (Q3 2014) (amounts in millions)**

**Net Revenues**

The table below and the discussion that follows are based upon the way in which we analyze our business. See Note 10 to the condensed consolidated financial statements for additional information about our business segments.

	Q3 2013	% of Net Sales	Q3 2014	% of Net Sales	\$ Change	% Change
Security division	\$ 99.8	50%	\$ 95.0	46%	\$ (4.8)	(5)%
Healthcare division	51.4	26%	52.2	26%	0.8	2%
Optoelectronics and Manufacturing division	54.8	28%	66.4	33%	11.7	21%
Less: inter-division sales	(7.6)	(4)%	(9.6)	(5)%	(2.1)	28%
Total revenues	\$ 198.4	100%	\$ 204.0	100%	\$ 5.6	3%

Net revenues for the three months ended March 31, 2014 increased \$5.6 million, or 3% to \$204.0 million, from \$198.4 million for the comparable prior-year period.

Revenues for the Security division for the three months ended March 31, 2014 decreased \$4.8 million, or 5%, to \$95.0 million, from \$99.8 million for the comparable prior-year period. The decrease was primarily attributable to a decrease in cargo equipment sales partially offset by increases in revenue from our turnkey screening services in Mexico.

Revenues for the Healthcare division were generally flat as compared to the prior year.

Revenues for the Optoelectronics and Manufacturing division for the three months ended March 31, 2014 increased \$11.7 million, or 21%, to \$66.4 million, from \$54.8 million for the comparable prior-year period. Excluding the impact of \$7.1 million of revenue attributable to acquired businesses over the last twelve months, the growth was 8%. This change was attributable to increases in contract manufacturing sales and sales to our Security and Healthcare divisions. Such intersegment sales are eliminated in consolidation.

**Gross Profit**

	Q3 2013	% of Net Sales	Q3 2014	% of Net Sales
Gross profit	\$ 71.8	36.2%	\$ 70.5	34.6%

Gross profit decreased \$1.3 million, or 2%, to \$70.5 million for the three months ended March 31, 2014, from \$71.8 million for the comparable prior-year period. The gross margin decreased to 34.6% from 36.2% for the comparable prior-year period, which was primarily attributable to: (i) the impact of increased revenues from our Optoelectronic and Manufacturing division which grew significantly faster than our other two higher gross margin divisions, (ii) the impact of the product mix within our Optoelectronics and Manufacturing division as a higher proportion of sales occurred in the contract manufacturing business, which carries lower gross margins than the optoelectronics business and (iii) increased depreciation associated with the increase of turnkey operations in our Security division. These factors were partially offset by significant improvements in margins in the cargo equipment business within our Security division, primarily as a result of more efficient manufacturing processes.

**Operating Expenses**

	Q3 2013	% of Net Sales	Q3 2014	% of Net Sales	\$ Change	% Change
Selling, general and administrative	\$ 37.8	19.0%	\$ 39.4	19.3%	\$ 1.6	4%
Research and development	12.3	6.2%	10.6	5.2%	(1.7)	(14)%
Impairment, restructuring and other charges	2.3	1.2%	2.5	1.2%	0.2	9%
Total operating expenses	\$ 52.4	26.4%	\$ 52.5	25.7%	\$ 0.1	0%

**Selling, general and administrative** . 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, 2014, SG&A expenses increased by \$1.6 million, or 4%, to \$39.4 million, from \$37.8 million for the comparable prior-year period. This increase was primarily attributable to increased costs to support the growth of the Company as well as increased professional fees. As a percentage of revenue, SG&A expenses were 19.3% for the three months ended March 31, 2014, compared to 19.0% for the comparable prior-year period.

**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, 2014, R&D expenses decreased by \$1.7 million or 14%, to \$10.6 million, from \$12.3 million primarily as a result of reduced spending relating to products that are nearing completion as well as resources moving from R&D activities to support newly developed products in our Security division.



**Impairment, restructuring and other charges** . During the three months ended March 31, 2014 we incurred \$2.5 million of impairment, restructuring and other charges, which was comprised of: \$0.3 million of employee termination costs and facility consolidation costs as we continue to optimize our cost structure, \$1.8 million of costs in our Security division related to contract issues with the U.S. federal government, and \$0.4 million of professional fees associated with a class action complaint that was filed against the Company. In the three months ended March 31, 2013, we incurred impairment, restructuring and other charges of \$2.3 million, made up of a \$1.7 million charge in our Security division and a \$0.6 million charge in our Optoelectronics and Manufacturing division.

### Other Income and Expenses

	Q3 2013	% of Net Sales	Q3 2014	% of Net Sales	\$ Change	% Change
Interest and other expense, net	\$ 1.3	0.7%	\$ 1.3	0.6%	\$ —	0%

**Interest and other expense, net** . For the three months ended March 31, 2014, interest and other expense, net, was unchanged as compared to the prior-year period.

**Income taxes** . For the three months ended March 31, 2014, our income tax provision was \$11.9 million, compared to \$4.5 million for the comparable prior-year period. Our effective tax rate for the three months ended March 31, 2014 was 71.2%, compared to 25.1% in the comparable prior-year period. Included within the income tax provision for the three months ended March 31, 2014 was a non-cash tax charge of \$7.6 million as a result of electing to accelerate the tax depreciation of certain fixed assets related to our turnkey screening solutions program in Mexico. This election resulted in a cash tax savings of approximately \$21.0 million in the three months ended March 31, 2014; however, portions of the tax bases of the underlying assets were forfeited resulting in a non-cash tax charge in the year the election was made. Excluding the impact of this charge, our effective tax rate for the three months ended March 31, 2014 would have been 25.3%. Effective for tax years beginning January 1, 2014, the election to accelerate depreciation is no longer available in the Mexican tax code. The effective tax rate for a particular period varies depending on a number of factors including (i) the mix of income earned in various tax jurisdictions, each of which applies a unique range of income tax rates and income tax credits, (ii) changes in previously established valuation allowances for deferred tax assets (changes are based upon our current analysis of the likelihood that these deferred tax assets will be realized), (iii) the level of non-deductible expenses, (iv) certain tax elections and (v) tax holidays granted to certain of our international subsidiaries.

### Results of Operations for the Nine Months Ended March 31, 2013 (YTD Q3 2013) Compared to Nine Months Ended March 31, 2014 (YTD Q3 2014) (amounts in millions)

#### Net Revenues

The table below and the discussion that follows are based upon the way in which we analyze our business. See Note 10 to the condensed consolidated financial statements for additional information about our business segments.

	YTD Q3 2013	% of Net Sales	YTD Q3 2014	% of Net Sales	\$ Change	% Change
Security division	\$ 274.6	48%	\$ 298.7	46%	\$ 24.1	9%
Healthcare division	159.1	28%	161.1	25%	2.0	1%
Optoelectronics and Manufacturing division	169.2	29%	214.0	33%	44.8	26%
Less: inter-division sales	(28.7)	(5)%	(27.2)	(4)%	1.5	(5)%
Total revenues	\$ 574.2	100%	\$ 646.6	100%	\$ 72.4	13%

Net revenues for the nine months ended March 31, 2014 increased \$72.4 million, or 13% to \$646.6 million, from \$574.2 million for the comparable prior-year period.

Revenues for the Security division for the nine months ended March 31, 2014 increased \$24.1 million, or 9%, to \$298.7 million, from \$274.6 million for the comparable prior-year period. The increase was primarily attributable to increased revenue from our turnkey screening services in Mexico and sales of cargo equipment, which was partially offset by the decrease in revenues associated with the London Olympic Games, which contributed approximately \$23 million in revenues in the prior year period.

Revenues for the Healthcare division were generally flat as compared to the prior year.



Revenues for the Optoelectronics and Manufacturing division for the nine months ended March 31, 2014 increased \$44.8 million, or 26%, to \$214.0 million, from \$169.2 million for the comparable prior-year period. Excluding the impact of \$17.9 million of revenue attributable to acquired businesses over the last twelve months, the growth was 16%. This change was primarily attributable to increases in contract manufacturing sales to customers in the consumer products business. The Optoelectronics and Manufacturing division recorded intersegment sales of \$27.2 million, compared to \$28.7 million in the comparable prior-year period. Such intersegment sales are eliminated in consolidation.

### Gross Profit

	YTD Q3 2013	% of Net Sales	YTD Q3 2014	% of Net Sales
Gross profit	\$ 203.3	35.4%	\$ 219.4	33.9%

Gross profit increased \$16.1 million, or 8%, to \$219.4 million for the nine months ended March 31, 2014, from \$203.3 million for the comparable prior-year period and was attributable to a 13% increase in sales. The gross margin decreased to 33.9% from 35.4% for the comparable prior-year period, which was primarily attributable to: (i) the impact of increased revenues from our Optoelectronic and Manufacturing division, which grew faster than our other two divisions, and which has historically generated the lowest gross margins across the three divisions; (ii) the impact of the product mix within our Optoelectronic and Manufacturing division, as a higher proportion of sales occurred in the contract manufacturing business, which carries lower gross margins than the optoelectronics business; (iii) the impact of a lower level of growth in our Healthcare division, which historically has generated the highest gross margin across the three divisions and (iv) increased depreciation associated with the increase of turnkey operations in our Security division. These factors were partially offset by significant improvements in margins in the cargo equipment business within our Security division, primarily as a result of more efficient manufacturing processes.

### Operating Expenses

	YTD Q3 2013	% of Net Sales	YTD Q3 2014	% of Net Sales	\$ Change	% Change
Selling, general and administrative	\$ 114.5	19.9%	\$ 127.2	19.7%	\$ 12.7	11%
Research and development	35.6	6.2%	32.8	5.1%	(2.8)	(8)%
Impairment, restructuring and other charges	5.0	0.9%	8.9	1.4%	3.9	78%
Total operating expenses	\$ 155.1	27.0%	\$ 168.9	26.2%	\$ 13.8	9%

**Selling, general and administrative** . Selling, general and administrative expenses consist primarily of compensation paid to sales, marketing and administrative personnel, professional service fees and marketing expenses. For the nine months ended March 31, 2014, SG&A expenses increased by \$12.7 million, or 11%, to \$127.2 million, from \$114.5 million for the comparable prior-year period. This increase was primarily attributable to increased cost to support our revenue growth and increased professional fees primarily in our Security division. As a percentage of revenue, SG&A expenses were 19.7% for the nine months ended March 31, 2014, compared to 19.9% for the comparable prior-year period.

**Research and development** . Research and development expenses include research related to new product development and product enhancement expenditures. For the nine months ended March 31, 2014, expenses decreased by \$2.8 million, or 8%, to \$32.8 million, from \$35.6 million primarily as a result of reduced spending relating to products that are nearing completion as well as resources moving from R&D activities to support newly developed products in our Security division.

**Impairment, restructuring and other charges** . During the nine months ended March 31, 2014, we incurred \$8.9 million of impairment, restructuring and other charges, which was comprised of: (i) \$2.2 million in our Security and our Optoelectronics and Manufacturing divisions for employee termination costs and costs related to facility consolidations; (ii) \$2.0 million in our Healthcare division related to our move into a new building to serve as the division's headquarters and primary manufacturing facility; (iii) \$4.3 million of costs incurred within our Security division related to contract issues with the U.S. federal government, and (iv) \$0.4 million of professional fees associated with a class action complaint that was filed against the Company. During the nine months ended March 31, 2013, we incurred impairment, restructuring and other charges of \$5.0 million. This was made up of \$2.7 million of costs as a result of the termination of an agreement with the TSA; and \$2.3 million of costs primarily consisting of severance for restructuring in our Security and Optoelectronics and Manufacturing divisions.

### Other Income and Expenses

	Q3 2013	% of Net Sales	Q3 2014	% of Net Sales	\$ Change	% Change
Interest and other expense, net	\$ 3.8	0.7%	\$ 4.3	0.7%	\$ 0.5	13%

**Interest and other expense, net** . For the nine months ended March 31, 2014, interest and other expense, net, was \$4.3 million as compared to \$3.8 million for the same prior-year period. The change was primarily due to increased interest expense related to higher average outstanding borrowings under our revolving credit facility to fund the investment in the Mexican turnkey services program and the mortgage debt associated with the acquisition of a building in September 2012 for which there was a nine month impact of the interest expense in fiscal 2014 as compared to six months in the comparable prior-year period.

**Income taxes** . For the nine months ended March 31, 2014, our income tax provision was \$20.4 million, compared to \$12.1 million for the comparable prior-year period. Our effective tax rate for the nine months ended March 31, 2014, was 44.2% compared to 27.3% in the comparable prior-year period. Included within the income tax provision for the three months ended March 31, 2014 was a non-cash tax charge of \$7.6 million as a result of electing to accelerate the tax depreciation of certain fixed assets related to our turnkey screening solutions program in Mexico. This election resulted in a cash tax savings of approximately \$21.0 million in the nine months ended March 31, 2014; however, portions of the tax bases of the underlying assets were forfeited resulting in a non-cash tax charge in the year the election was made. Excluding the impact of this charge, our effective tax rate for the nine months ended March 31, 2014 would have been 27.7%. Effective for tax years beginning January 1, 2014, the election to accelerate depreciation is no longer available in the Mexican tax code. The effective tax rate for a particular period varies depending on a number of factors including (i) the mix of income earned in various tax jurisdictions, each of which applies a unique range of income tax rates and income tax credits, (ii) changes in previously established valuation allowances for deferred tax assets (changes are based upon our current analysis of the likelihood that these deferred tax assets will be realized), (iii) the level of non-deductible expenses, (iv) certain tax elections and (v) tax holidays granted to certain of our international subsidiaries.

## Liquidity and Capital Resources

Our principal sources of liquidity are our cash and cash equivalents, cash generated from operations and our credit facility. Cash and cash equivalents totaled \$39.8 million at March 31, 2014, an increase of \$5.2 million from the \$34.7 million at June 30, 2013. During the nine months ended March 31, 2014, we generated \$123.8 million of cash flow from operations. These proceeds were used for the following: \$48.1 million invested in capital expenditures, \$37.0 million in the repayment of bank lines of credit, \$15.9 million for the acquisition of businesses and other assets and \$ 20.5 million for the repurchase of our common stock, including net share settlement of equity awards. If we continue to net settle equity awards, we will use additional cash to pay our tax withholding obligations in connection with such settlements. We currently anticipate that our available funds, credit facilities and cash flow from operations will be sufficient to meet our operational cash needs for the foreseeable future. In addition, without repatriating earnings from non-U.S. subsidiaries, we anticipate that cash generated from operations will be able to satisfy our obligations in the U.S., including our outstanding lines of credit as accounting earnings in the U.S. are not necessarily indicative of cash flows since earnings are generally reduced by non-cash expenses including depreciation, amortization, and stock-based compensation.

We have a five-year revolving credit facility that allows us to borrow up to \$425 million at London Interbank Offered Rate (LIBOR) plus 1.5% depending upon our leverage ratio. As of March 31, 2014, there was \$22.0 million outstanding under the revolving credit facility and \$112.0 million outstanding under the letters-of-credit sub-facility.

*Cash Provided by Operating Activities.* Cash flows from operating activities can fluctuate significantly from period to period, as net income, adjusted for non-cash items, and working capital fluctuations impact cash flows. During the nine months ended March 31, 2014, we generated cash from operations of \$123.8 million compared to \$57.2 million in the prior year period, or an increase of \$66.5 million. Cash flow from operating activities during the first nine months of fiscal 2014 primarily consisted of net income of \$25.8 million, adjusted for certain non-cash items, including total depreciation and amortization of \$40.0 million, stock-based compensation expense of \$14.0 million, deferred income taxes of \$25.8 million and other non-cash operating items of \$0.9 million, and the net positive impact of changes in working capital on cash of \$17.3 million. The \$66.5 million increase in cash from operations primarily resulted from the impact of changes in net income after giving consideration to non-cash operating items as noted above, which increased by \$41.9 million, and due to a \$24.6 million increase in changes in cash flow from changes in working capital. The primary driver of the change in cash flow from working capital was an \$83.5 million increase in the change in cash flow from accounts receivables and a \$48.8 million increase in the change in cash flow from deferred revenue partially offset by a \$52.0 million decrease in the change in cash flow from accounts payables, a \$37.0 million decrease in the change in cash flow from prepaid expenses and other assets and \$23.9 million decrease in the change in cash flow from inventories.

*Cash Used in Investing Activities.* Net cash used in investing activities was \$64.0 million for the nine months ended March 31, 2014 as compared to \$149.3 million used for the nine months ended March 31, 2013. During the nine months ended March 31, 2014, we invested \$48.1 million in capital expenditures compared to \$139.4 million during the comparable prior-year period. This decrease is primarily a result of the timing of capital expenditures in support of our turnkey screening program in Mexico. In the nine months ended March 31, 2014 we also used cash of \$11.6 million for acquisitions of businesses and other assets as compared to \$6.1 million in the comparable prior-year period.

*Cash Provided by (Used in) Financing Activities.* Net cash used by financing activities was \$55.7 million for the nine months ended March 31, 2014, compared to \$49.1 million of net cash provided by financing activities for the nine months ended March 31, 2013. During the nine months ended March 31, 2014, we paid down our outstanding bank lines of credit by \$37.0 million as compared to receiving \$55.0 million in the prior year. During the nine months ended March 31, 2014, we repurchased \$20.5 million of our common stock including net share settlement of equity awards compared to \$20.7 million for the same period in the prior year. Cash provided by financing in the prior year period included \$10.3 million related to the loan for our new headquarters in our Healthcare division.

## Borrowings

Outstanding lines of credit and current and long-term debt totaled \$35.6 million at March 31, 2014, a decrease of \$35.9 million from \$71.5 million at June 30, 2013. See Note 4 to the condensed consolidated financial statements for further discussion.

## Cash Held by Foreign Subsidiaries

Our cash, cash equivalents, and investments totaled \$39.8 million at March 31, 2014. Of this amount, approximately 57% was held by our foreign subsidiaries and subject to repatriation tax considerations. These foreign funds were located primarily in Malaysia and China, and to a lesser extent in Mexico, India, Singapore, the United Kingdom, Germany and Canada amongst others. We intend to permanently reinvest a significant portion of our earnings from foreign operations, and we currently do not anticipate that we will need this cash in foreign countries to fund our U.S. operations. In the event that funds from foreign operations are needed to fund operations in the United States and if U.S. taxes have not been previously provided on the related earnings, we would provide for and pay additional U.S. taxes at the time we change our intention with regard to the reinvestment of those earnings.

## Stock Repurchase Program

Our Board of Directors has authorized a stock repurchase program that provides for the repurchase of up to 4,000,000 shares of our common stock. This program does not have an expiration date. Upon repurchase, the shares are restored to the status of authorized but unissued, and we record them as a reduction in the number of shares of common stock issued and outstanding in our consolidated financial statements.

The following table contains information about the shares acquired during the quarter ended March 31, 2014:

	Total number of shares (or units) purchased (1)	Average price paid per share (or unit)	Total number of shares (or units) purchased as part of publicly announced plans or programs	Maximum number (or appropriate dollar value) of shares (or units) that may yet be purchased under the plans or programs
January 1, 2014 to January 31, 2014	106	\$ 55.51	—	1,219,195
February 1, 2014 to February 28, 2014	3,262	\$ 58.74	—	1,219,195
March 1, 2014 to March 31, 2014	33	\$ 64.24	—	1,219,195
	<u>3,401</u>	<u>\$ 58.70</u>	<u>—</u>	

(1) Represents shares of common stock surrendered by employees to satisfy minimum statutory tax withholding obligations related to the vesting of restricted shares.

## Dividend Policy

We have not paid cash dividends on our common stock in the past and have no plans to do so in the foreseeable future. Certain of our current bank credit facilities restrict the payment of cash dividends and future borrowings may contain similar restrictions.

## **Contractual Obligations**

We presented our contractual obligations in our Annual Report on Form 10-K for the fiscal year ended June 30, 2013. See Note 8 to the condensed consolidated financial statements for further discussion regarding significant changes in those obligations during the first nine months of fiscal 2014.

## **Off Balance Sheet Arrangements**

As of March 31, 2014, we did not have any significant off balance sheet arrangements as defined in Item 303(a)(4) of Regulation S-K.

## **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, 2013.

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

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

For the nine months ended March 31, 2014, 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, 2013.

### **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**

Our international operations are subject to certain opportunities and risks, including foreign currency fluctuations and governmental actions. We closely monitor our operations in each country and seek to adopt appropriate strategies that are responsive to changing economic and political environments, and to fluctuations in foreign currencies. We conduct business in more than 20 countries. Due to our global operations, weaknesses in the currencies of some of these countries are often offset by strengths in others. Foreign currency financial statements are translated into U.S. dollars at period-end rates, with the exception of revenues, costs and expenses, which 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 accumulated other comprehensive income. Transaction gains and losses, which were included in our condensed consolidated statements of operations, amounted to a gain of \$3.0 million from foreign exchange during the three months ended March 31, 2013 and a loss of \$0.3 million during the three months ended March 31, 2014. We recognized a gain of \$2.5 million and a loss of \$1.2 million for the nine months ended March 31, 2013 and 2014, respectively. Furthermore, 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 2014. 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 second quarter of fiscal 2014.

### **Use of Derivatives**

Our use of derivatives consists primarily of an interest swap agreement. As discussed in Note 1 to the condensed consolidated financial statements, we had an interest rate swap of \$8.8 million outstanding as of March 31, 2014.

## **Importance of International Markets**

International markets provide us with significant growth opportunities. However, as a result of our worldwide business operations, we are 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, 2014.

## **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.

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

### *Evaluation of Disclosure Controls and Procedures*

Based upon an evaluation of the effectiveness of disclosure controls and procedures, our Chief Executive Officer (CEO) and Chief Financial Officer (CFO) have concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures as defined under Exchange Act Rule 13a-15(e) and 15d-15(e) were effective to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission and is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

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

There were no changes in our internal control over financial reporting during the third quarter of fiscal 2014 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 our 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. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

## **PART II OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

Certain of the legal proceedings in which we are involved are discussed in Note 8, "Commitments and Contingencies," to our Unaudited Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q, and are hereby incorporated by reference.

### **ITEM 1A. RISK FACTORS**

The discussion of our business and operations in this Quarterly Report on Form 10-Q should be read together with the risk factors contained in our Annual Report on Form 10-K for the fiscal year ended June 30, 2013, filed with the Securities and Exchange Commission on August 16, 2013, which describe various risks and uncertainties to which we are or may become subject. There have been no material changes to the risk factors included in our Annual Report.

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

See Stock Repurchase Program discussion under Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations, which is hereby incorporated by reference.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

**None.**

### **ITEM 4. MINE SAFETY DISCLOSURES**

**Not applicable**

### **ITEM 5. OTHER INFORMATION**

On April 25, 2014, the Administrative Committee of the Board of Directors approved the Amended and Restated OSI Systems, Inc. Deferred Compensation Plan (the “Amended and Restated Deferred Compensation Plan”). The Amended and Restated Deferred Compensation Plan allows a select group of our management and highly compensated employees to defer receipt of a portion of their salary, bonus, commission and other specified compensation, and amends, amongst other things, the terms of certain participant benefits.

The foregoing description of the Amended and Restated Deferred Compensation Plan is qualified in its entirety by reference to the full text of the plan document, which is attached as Exhibit 10.1 and is incorporated herein by reference.

### **ITEM 6. EXHIBITS**

- 10.1 Amended and Restated OSI Systems, Inc. Deferred Compensation Plan
- 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
- 101.1 The following financial information from the Registrant’s Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, as filed with the SEC on May 2, 2014, formatted in XBRL, as follows:
  - (i) the condensed consolidated balance sheets
  - (ii) the condensed consolidated statements of operations
  - (iii) the condensed consolidated statements of comprehensive income
  - (iv) the condensed consolidated statements of cash flows
  - (v) the notes to the condensed consolidated financial statements, tagged in summary and detail

**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 1st day of May 2014.

**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

AMENDED AND RESTATED OSI SYSTEMS, INC.

DEFERRED COMPENSATION PLAN

Effective  
April 25, 2014

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## **ARTICLE I**

### *Establishment and Purpose*

OSI Systems, Inc. (the “Company”) hereby adopts the Amended and Restated OSI Systems, Inc. Deferred Compensation Plan (the “Plan”), effective April 25, 2014. The Plan amends and restates in its entirety the OSI Systems, Inc. Deferred Compensation Plan.

The purpose of the Plan is to attract and retain key employees by providing each Participant with an opportunity to defer receipt of a portion of their salary, bonus, commission, and other specified compensation (if any). The Plan is not intended to meet the qualification requirements of Code Section 401(a), but is intended to meet the requirements of Code Section 409A, and shall be operated and interpreted consistent with that intent.

The Plan constitutes an unsecured promise by a Participating Employer to pay benefits in the future. Participants in the Plan shall have the status of general unsecured creditors of the Company or the Adopting Employer, as applicable. Each Participating Employer shall be solely responsible for payment of the benefits of its employees and their beneficiaries. The Plan is unfunded for Federal tax purposes and is intended to be an unfunded arrangement for eligible employees who are part of a select group of management or highly compensated employees of the Employer within the meaning of Sections 201(2), 301(a)(3) and 401(a)(1) of ERISA. Any amounts set aside to defray the liabilities assumed by the Company or an Adopting Employer will remain the general assets of the Company or the Adopting Employer and shall remain subject to the claims of the Company’s or the Adopting Employer’s creditors until such amounts are distributed to the Participants.

## **ARTICLE II**

### *Definitions*

- 2.1 Account. Account means a bookkeeping account maintained by the Committee to record the payment obligation of a Participating Employer to a Participant as determined under the terms of the Plan. The Committee may maintain an Account to record the total obligation to a Participant and component Accounts to reflect amounts payable at different times and in different forms. Reference to an Account means any such Account established by the Committee, as the context requires. Accounts are intended to constitute unfunded obligations within the meaning of Sections 201(2), 301(a)(3) and 401(a)(1) of ERISA.
  - 2.2 Account Balance. Account Balance means, with respect to any Account, the total payment obligation owed to a Participant from such Account as of the most recent Valuation Date.
  - 2.3 Adopting Employer. Adopting Employer means an Affiliate who, with the consent of the Company, has adopted the Plan for the benefit of its eligible employees.
  - 2.4 Affiliate. Affiliate means a corporation, trade or business that, together with the Company, is treated as a single employer under Code Section 414(b) or (c).
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- 2.5 Beneficiary. Beneficiary means a natural person, estate, or trust designated by a Participant to receive payments to which a Beneficiary is entitled in accordance with provisions of the Plan. The Participant's spouse, if living, otherwise the Participant's estate, shall be the Beneficiary if: (i) the Participant has failed to properly designate a Beneficiary; or (ii) all designated Beneficiaries have predeceased the Participant.
- 2.6 Business Day. A Business Day is each day on which the New York Stock Exchange is open for business.
- 2.7 Change in Control. Change in Control, with respect to a Participating Employer that is organized as a corporation, occurs on the date on which any of the following events occur: (i) a change in the ownership of the Participating Employer; (ii) a change in the effective control of the Participating Employer; or (iii) a change in the ownership of a substantial portion of the assets of the Participating Employer.

For purposes of this Section, a change in the ownership of the Participating Employer occurs on the date on which any one person, or more than one person acting as a group, acquires ownership of stock of the Participating Employer that, together with stock held by such person or group constitutes more than fifty percent (50%) of the total fair market value or total voting power of the stock of the Participating Employer. A change in the effective control of the Participating Employer occurs on the date on which either: (i) a person, or more than one person acting as a group, acquires ownership of stock of the Participating Employer possessing thirty percent (30%) or more of the total voting power of the stock of the Participating Employer, taking into account all such stock acquired during the twelve (12) month period ending on the date of the most recent acquisition; or (ii) a majority of the members of the Participating Employer's Board of Directors is replaced during any twelve (12) month period by directors whose appointment or election is not endorsed by a majority of the members of such Board of Directors prior to the date of the appointment or election, but only if no other corporation is a majority shareholder of the Participating Employer. A change in the ownership of a substantial portion of assets occurs on the date on which any one person, or more than one person acting as a group, other than a person or group of persons that is related to the Participating Employer, acquires assets from the Participating Employer that have a total gross fair market value equal to or more than forty percent (40%) of the total gross fair market value of all of the assets of the Participating Employer immediately prior to such acquisition or acquisitions, taking into account all such assets acquired during the twelve (12) month period ending on the date of the most recent acquisition.

An event constitutes a Change in Control with respect to a Participant only if the Participant performs services for the Participating Employer that has experienced the Change in Control, or the Participant's relationship to the affected Participating Employer otherwise satisfies the requirements of Treasury Regulation Section 1.409A-3(i)(5)(ii).

The determination as to the occurrence of a Change in Control shall be based on objective facts and in accordance with the requirements of Code Section 409A.

- 2.8 Claimant. Claimant means a Participant or Beneficiary filing a claim under Article XII of this Plan.
- 2.9 Code. Code means the Internal Revenue Code of 1986, as amended from time to time.
- 2.10 Code Section 409A. Code Section 409A means section 409A of the Code, and regulations and other guidance issued by the Treasury Department and Internal Revenue Service thereunder.
- 2.11 Committee. Committee means the Employees of the Company appointed by the Board of Directors of the Company (or the appropriate committee of such board), and their replacements as authorized by the Board of Directors, to administer the Plan.
- 2.12 Company. Company means OSI Systems, Inc.
- 2.13 Company Contribution. Company Contribution means a credit by a Participating Employer to a Participant's Account(s) in accordance with the provisions of Article V of the Plan. Company Contributions are credited at the sole discretion of the Participating Employer and the fact that a Company Contribution is credited in one year shall not obligate the Participating Employer to continue to make such Company Contribution in subsequent years. Unless the context clearly indicates otherwise, a reference to Company Contribution shall include Earnings attributable to such contribution.
- 2.14 Compensation. Compensation means a Participant's base salary, bonus, commission, and such other cash or equity-based compensation (if any) approved by the Committee as Compensation that may be deferred under this Plan. Compensation shall not include any compensation that has been previously deferred under this Plan or any other arrangement subject to Code Section 409A.
- 2.15 Compensation Deferral Agreement. Compensation Deferral Agreement means an agreement between a Participant and a Participating Employer that specifies: (i) the amount of each component of Compensation that the Participant has elected to defer to the Plan in accordance with the provisions of Article IV; and (ii) the Payment Schedule applicable to one or more Accounts. The Committee may permit different deferral amounts for each component of Compensation and may establish a minimum or maximum deferral amount for each such component. Unless otherwise specified by the Committee in the Compensation Deferral Agreement, Participants may defer up to eighty percent (80%) of their base salary and up to one hundred percent (100%) of other types of Compensation for a Plan Year. A Compensation Deferral Agreement may also specify the investment allocation described in Section 8.4.
- 2.16 Corrective Distribution. Corrective Distribution means the amount of any 401(k) plan Excess Contribution (within the meaning of Code Section 401(k)(8) which is distributed to a Participant during any Plan Year.
- 2.17 Death Benefit. Death Benefit means the benefit payable under the Plan to a Participant's Beneficiary(ies) upon the Participant's death as provided in Section 6.1 of the Plan.

- 2.18 Deferral. Deferral means a credit to a Participant's Account(s) that records that portion of the Participant's Compensation that the Participant has elected to defer to the Plan in accordance with the provisions of Article IV. Unless the context of the Plan clearly indicates otherwise, a reference to Deferrals includes Earnings attributable to such Deferrals.
- Deferrals shall be calculated with respect to the gross cash Compensation payable to the Participant prior to any deductions or withholdings, but shall be reduced by the Committee as necessary so that it does not exceed one hundred percent (100%) of the cash Compensation of the Participant remaining after deduction of all required income and employment taxes, 401(k) and other employee benefit deductions, and other deductions required by law. Changes to payroll withholdings that affect the amount of Compensation being deferred to the Plan shall be allowed only to the extent permissible under Code Section 409A.
- 2.19 Disabled or Disability. Disabled or Disability means that a Participant is, by reason of any medically-determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months: (a) unable to engage in any substantial gainful activity, or (b) receiving income replacement benefits for a period of not less than three months under an accident and health plan covering employees of the Participant's Employer. The Committee shall determine whether a Participant is Disabled in accordance with Code Section 409A, provided, however, that a Participant shall be deemed to be Disabled if determined to be totally disabled by the Social Security Administration. The determination of whether a Participant is Disabled shall be made in compliance with Treas. Reg. §1.409A-3(i)(4).
- 2.20 Disability Benefit. Disability Benefit means the benefit payable under the Plan upon the Participant's Disability, as provided under Section 6.1 of the Plan.
- 2.21 Earnings. Earnings means an adjustment to the value of an Account in accordance with Article VIII.
- 2.22 Effective Date. Effective Date means, for purposes of the Plan (as amended and restated), April 25, 2014, the date on which the Plan (as amended and restated) was adopted by the Board.
- 2.23 Eligible Employee. Eligible Employee means a member of a "select group of management or highly compensated employees" of a Participating Employer within the meaning of Sections 201(2), 301(a)(3) and 401(a)(1) of ERISA, as determined by the Committee from time to time in its sole discretion.
- 2.24 Employee. Employee means a common-law employee of an Employer.
- 2.25 Employer. Employer means, with respect to Employees it employs, the Company and each Affiliate.
- 2.26 ERISA. ERISA means the Employee Retirement Income Security Act of 1974, as amended from time to time.

- 2.27 Participant. Participant means an Eligible Employee who has been given notification of his or her eligibility to defer Compensation under the Plan under Section 3.1 and any other person with an Account Balance greater than zero, regardless of whether such individual continues to be an Eligible Employee. A Participant's continued participation in the Plan shall be governed by Section 3.2 of the Plan.
- 2.28 Participating Employer. Participating Employer means the Company and each Adopting Employer.
- 2.29 Payment Schedule. Payment Schedule means the date as of which payment of an Account under the Plan will commence and the form in which payment of such Account will be made.
- 2.30 Performance-Based Compensation. Performance-Based Compensation means Compensation where the amount of, or entitlement to, the Compensation is contingent on the satisfaction of pre-established organizational or individual performance criteria relating to a performance period of at least twelve (12) consecutive months. Organizational or individual performance criteria are considered pre-established if established in writing by not later than ninety (90) days after the commencement of the period of service to which the criteria relate, provided that the outcome is substantially uncertain at the time the criteria are established. The determination of whether Compensation qualifies as "Performance-Based Compensation" will be made in accordance with Treas. Reg. Section 1.409A-1(e) and subsequent guidance.
- 2.31 Plan. Generally, the term Plan means the "Amended and Restated OSI Systems, Inc. Deferred Compensation Plan" as documented herein and as may be amended from time to time hereafter. However, to the extent permitted or required under Code Section 409A, the term Plan may in the appropriate context also mean a portion of the Plan that is treated as a single plan under Treas. Reg. Section 1.409A-1(c), or the Plan or portion of the Plan and any other nonqualified deferred compensation plan or portion thereof that is treated as a single plan under such section.
- 2.32 Plan Year. Plan Year means January 1 through December 31.
- 2.33 Separation from Service. An Employee incurs a Separation from Service upon termination of employment with the Employer. Whether a Separation from Service has occurred shall be determined by the Committee in accordance with Code Section 409A.

Except in the case of an Employee on a bona fide leave of absence as provided below, an Employee is deemed to have incurred a Separation from Service if the Employer and the Employee reasonably anticipated that the level of services to be performed by the Employee after a date certain would be reduced to twenty percent (20%) or less of the average services rendered by the Employee during the immediately preceding thirty-six (36) month period (or the total period of employment, if less than thirty-six (36) months), disregarding periods during which the Employee was on a bona fide leave of absence.

An Employee who is absent from work due to military leave, sick leave, or other bona fide leave of absence shall incur a Separation from Service on the first date immediately

following the later of: (i) the six (6) month anniversary of the commencement of the leave; or (ii) the expiration of the Employee's right, if any, to reemployment under statute or contract. Notwithstanding the preceding, however, an Employee who is absent from work due to a physical or mental impairment that is expected to result in death or last for a continuous period of at least six (6) months and that prevents the Employee from performing the duties of his position of employment or a similar position shall incur a Separation from Service on the first date immediately following the twenty-ninth (29) month anniversary of the commencement of the leave.

For purposes of determining whether a Separation from Service has occurred, the Employer means the Employer as defined in Section 2.23 of the Plan, except that for purposes of determining whether another organization is an Affiliate of the Company, common ownership of at least fifty percent (50%) shall be determinative.

The Committee specifically reserves the right to determine whether a sale or other disposition of substantial assets to an unrelated party constitutes a Separation from Service with respect to a Participant providing services to the seller immediately prior to the transaction and providing services to the buyer after the transaction. Such determination shall be made in accordance with the requirements of Code Section 409A.

- 2.34 Separation from Service Account. Separation from Service Account means an Account established by the Committee to record the amounts payable to a Participant upon Separation from Service. Unless the Participant has established a Specified Date Account for a portion or all of his/her Deferrals, all Deferrals shall be allocated to the Separation from Service Account on behalf of the Participant.
- 2.35 Separation from Service Benefit. Separation from Service Benefit means the benefit payable to a Participant under the Plan following the Participant's Separation from Service.
- 2.36 Specified Date Account. A Specified Date Account means an Account established by the Committee to record the amounts payable at a future date as specified in the Participant's Compensation Deferral Agreement. Unless otherwise determined by the Committee, a Participant may maintain no more than five (5) Specified Date Accounts. A Specified Date Account may be identified in enrollment materials as an "In-Service Account" or such other name as established by the Committee without affecting the meaning thereof.
- 2.37 Specified Date Benefit. Specified Date Benefit means the benefit payable to a Participant under the Plan in accordance with Section 6.1(c).
- 2.38 Specified Employee. Specified Employee means an Employee who, as of the date of his Separation from Service, is a "key employee" of the Company or any Affiliate, any stock of which is actively traded on an established securities market or otherwise.

An Employee is a key employee if he or she meets the requirements of Code Section 416(i)(1)(A)(i), (ii), or (iii) (applied in accordance with applicable regulations thereunder and without regard to Code Section 416(i)(5)) at any time during the twelve (12) month period ending on the Specified Employee Identification Date. Such

Employee shall be treated as a key employee for the entire twelve (12) month period beginning on the Specified Employee Effective Date.

For purposes of determining whether an Employee is a Specified Employee, the compensation of the Employee shall be determined in accordance with the definition of compensation provided under Treas. Reg. Section 1.415(c)-2(d)(3) (wages within the meaning of Code section 3401(a) for purposes of income tax withholding at the source, plus amounts excludible from gross income under section 125(a), 132(f) (4), 402(e)(3), 402(h)(1)(B), 402(k) or 457(b), without regard to rules that limit the remuneration included in wages based on the nature or location of the employment or the services performed); provided, however, that, with respect to a nonresident alien who is not a Participant in the Plan, compensation shall not include compensation that is not includible in the gross income of the Employee under Code Sections 872, 893, 894, 911, 931 and 933, provided such compensation is not effectively connected with the conduct of a trade or business within the United States.

Notwithstanding anything in this paragraph to the contrary: (i) if a different definition of compensation has been designated by the Company with respect to another nonqualified deferred compensation plan in which a key employee participates, the definition of compensation shall be the definition provided in Treas. Reg. Section 1.409A-1(i)(2); and (ii) the Company may through action that is legally binding with respect to all nonqualified deferred compensation plans maintained by the Company, elect to use a different definition of compensation.

In the event of corporate transactions described in Treas. Reg. Section 1.409A-1(i)(6), the identification of Specified Employees shall be determined in accordance with the default rules described therein, unless the Employer elects to utilize the available alternative methodology through designations made within the timeframes specified therein.

- 2.39 Specified Employee Identification Date. Specified Employee Identification Date means December 31, unless the Employer has elected a different date through action that is legally binding with respect to all nonqualified deferred compensation plans maintained by the Employer.
- 2.40 Specified Employee Effective Date. Specified Employee Effective Date means the first day of the fourth (4<sup>th</sup>) month following the Specified Employee Identification Date, or such earlier date as is selected by the Committee.
- 2.41 Substantial Risk of Forfeiture. Substantial Risk of Forfeiture shall have the meaning specified in Treas. Reg. Section 1.409A-1(d).
- 2.42 Unforeseeable Emergency. An Unforeseeable Emergency means a severe financial hardship to the Participant resulting from an illness or accident of the Participant, the Participant's spouse, the Participant's dependent (as defined in Code section 152, without regard to section 152(b)(1), (b)(2), and (d)(1)(B)), or a Beneficiary; loss of the Participant's property due to casualty (including the need to rebuild a home following damage to a home not otherwise covered by insurance, for example, as a result of a



natural disaster); or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the Participant. The types of events which may qualify as an Unforeseeable Emergency may be limited by the Committee.

2.43 Valuation Date . Valuation Date shall mean each Business Day.

### **ARTICLE III**

#### *Eligibility and Participation*

3.1 Eligibility and Participation . An Eligible Employee becomes a Participant upon the earlier to occur of: (i) a credit of Company Contributions under Article V; or (ii) notification of eligibility to participate by the Committee or its authorized representative.

3.2 Duration . A Participant shall be eligible to defer Compensation and receive allocations of Company Contributions, subject to the terms of the Plan, for as long as such Participant remains an Eligible Employee. A Participant who is no longer an Eligible Employee but has not experienced a Separation from Service may not defer Compensation under the Plan but may otherwise exercise all of the rights of a Participant under the Plan with respect to his or her Account(s). On and after a Separation from Service, a Participant shall remain a Participant as long as his or her Account Balance is greater than zero, and during such time may continue to make allocation elections as provided in Section 8.4. An individual shall cease being a Participant in the Plan when all benefits under the Plan to which he or she is entitled have been paid.

### **ARTICLE IV**

#### *Deferrals*

4.1 Deferral Elections, Generally .

- (a) A Participant may elect to defer Compensation by submitting a Compensation Deferral Agreement during the enrollment periods established by the Committee and in the manner specified by the Committee, but in any event, in accordance with Section 4.2. A Compensation Deferral Agreement that is not timely filed with respect to a service period or component of Compensation shall be considered void and shall have no effect with respect to such service period or Compensation. The Committee may modify any Compensation Deferral Agreement prior to the date the election becomes irrevocable under the rules of Section 4.2 and may limit in its sole discretion the format, timing, components and other elements of any election to defer Compensation under this Article IV, subject to the limitations contained in the Plan.
- (b) The Participant shall specify on his or her Compensation Deferral Agreement the amount of Deferrals and the allocation of such Deferrals in accordance with Section 4.3. A Participant may also specify in his or her Compensation Deferral Agreement the Payment Schedule applicable to his or her Plan Accounts. If the Payment Schedule is not specified in a Compensation Deferral Agreement, the Payment Schedule shall be the Payment Schedule specified in Section 6.2.

- (c) A deferral election shall also indicate whether a Participant elects to defer an additional amount of Compensation equal in amount to any Corrective Distribution received during the Plan Year to which the deferral election refers (“Corrective Distribution Equivalent Deferral”). Unless otherwise determined by the Committee, in the event that a Participant elects a Corrective Distribution Equivalent Deferral, the total amount of such Deferral will be divided by the number of pay periods remaining in the Plan Year following the receipt by the Participant of the Corrective Distribution, and the resulting amount will be added to the percentage of base salary deferred by such Participant.

#### 4.2 Timing Requirements for Compensation Deferral Agreements .

- (a) *First Year of Eligibility .* In the case of the first (1<sup>st</sup>) year in which an Eligible Employee becomes eligible to participate in the Plan, if permitted by the Committee, he or she has up to thirty (30) days following initial eligibility to submit a Compensation Deferral Agreement with respect to Compensation to be earned during such year. The Compensation Deferral Agreement described in this paragraph becomes irrevocable upon the end of such thirty (30) day period, or such earlier date as the Committee may provide. The determination of whether an Eligible Employee may file a Compensation Deferral Agreement under this paragraph shall be determined in accordance with the rules of Code Section 409A, including the provisions of Treas. Reg. Section 1.409A-2(a)(7).

A Compensation Deferral Agreement filed under this paragraph applies only to Compensation earned on and after the date the Compensation Deferral Agreement becomes irrevocable.

- (b) *Prior Year Election .* Except as otherwise provided in this Section 4.2, if permitted by the Committee, Participants may defer Compensation by filing a Compensation Deferral Agreement no later than December 31 of the year prior to the year in which the Compensation to be deferred is earned. A Compensation Deferral Agreement described in this paragraph shall become irrevocable with respect to such Compensation as of January 1 of the year in which such Compensation is earned.
- (c) *Performance-Based Compensation .* If permitted by the Committee, Participants may file a Compensation Deferral Agreement with respect to Performance-Based Compensation no later than the date that is six (6) months before the end of the performance period, provided that:
  - (i) the Participant performs services continuously from the later of the beginning of the performance period or the date the criteria are established through the date the Compensation Deferral Agreement is submitted; and
  - (ii) the Compensation is not readily ascertainable as of the date the Compensation Deferral Agreement is filed.

A Compensation Deferral Agreement becomes irrevocable with respect to Performance-Based Compensation as of the day immediately following the latest date for filing such election. Any election to defer Performance-Based Compensation that is made in accordance with this paragraph and that becomes payable as a result of the Participant's death or disability (as defined in Treas. Reg. Section 1.409A-1(e)) or upon a Change in Control (as defined in Treas. Reg. Section 1.409A-3(i)(5)) prior to the satisfaction of the performance criteria, will be void.

- (d) *Sales Commissions* . Sales commissions (as defined in Treas. Reg. Section 1.409A-2(a)(12)(i)) are considered to be earned by the Participant in the taxable year of the Participant in which the sale occurs. The Compensation Deferral Agreement applicable to any sales commissions, if permitted by the Committee, must be filed before the last day of the year preceding the year in which the sales commissions are earned, and becomes irrevocable after that date.
- (e) *Short-Term Deferrals* . Compensation that meets the definition of a "short-term deferral" described in Treas. Reg. Section 1.409A-1(b)(4) may, if permitted by the Committee, be deferred in accordance with the rules of Article VII, applied as if the date the Substantial Risk of Forfeiture lapses is the date payments were originally scheduled to commence, provided, however, that the provisions of Section 7.3 shall not apply to payments attributable to a Change in Control (as defined in Treas. Reg. Section 1.409A-3(i)(5)).
- (f) *Certain Forfeitable Rights* . With respect to a legally binding right to a payment in a subsequent year that is subject to a forfeiture condition requiring the Participant's continued services for a period of at least twelve (12) months from the date the Participant obtains the legally binding right, an election to defer such Compensation may, if permitted by the Committee, be made on or before the thirtieth (30<sup>th</sup>) day after the Participant obtains the legally binding right to the Compensation, provided that the election is made at least twelve (12) months in advance of the earliest date at which the forfeiture condition could lapse. The Compensation Deferral Agreement described in this paragraph becomes irrevocable after such thirtieth (30<sup>th</sup>) day. If the forfeiture condition applicable to the payment lapses before the end of the required service period as a result of the Participant's death or disability (as defined in Treas. Reg. Section 1.409A-3(i)(4)) or upon a Change in Control (as defined in Treas. Reg. Section 1.409A-3(i)(5)), the Compensation Deferral Agreement will be void unless it would be considered timely under another rule described in this Section.
- (g) *Company Awards* . Participating Employers may unilaterally provide for deferrals of Company awards prior to the date of such awards. Deferrals of Company awards (such as sign-on, retention, or severance pay) may be negotiated with a Participant prior to the date the Participant has a legally binding right to such Compensation.

(h) “Evergreen” Deferral Elections . The Committee, in its discretion, may provide in the Compensation Deferral Agreement that such Compensation Deferral Agreement will continue in effect for each subsequent year or performance period. Such “evergreen” Compensation Deferral Agreements will become effective with respect to an item of Compensation on the date such election becomes irrevocable under this Section 4.2. An evergreen Compensation Deferral Agreement may be terminated or modified prospectively with respect to Compensation for which such election remains revocable under this Section 4.2. A Participant whose Compensation Deferral Agreement is cancelled in accordance with Section 4.6 will be required to file a new Compensation Deferral Agreement under this Article IV in order to recommence Deferrals under the Plan.

4.3 Allocation of Deferrals . A Compensation Deferral Agreement may, if permitted by the Committee, allocate Deferrals to one or more Specified Date Accounts and/or to the Separation from Service Account. If no designation is made, Deferrals shall be allocated to the Separation from Service Account. The Committee may, in its discretion, establish a minimum deferral period for Specified Date Accounts (for example, the third (3<sup>rd</sup>) Plan Year following the year Compensation subject to the Compensation Deferral Agreement is earned).

4.4 Deductions from Pay . The Committee has the authority to determine the payroll practices under which any component of Compensation subject to a Compensation Deferral Agreement will be deducted from a Participant’s Compensation.

4.5 Vesting . Participant Deferrals shall be one hundred percent (100%) vested at all times.

4.6 Cancellation of Deferrals . The Committee may cancel a Participant’s Deferrals: (i) for the balance of the Plan Year in which an Unforeseeable Emergency occurs; (ii) if the Participant receives a hardship distribution under the Employer’s qualified 401(k) plan, through the end of the Plan Year in which the six (6) month anniversary of the hardship distribution falls; and (iii) during periods in which the Participant is unable to perform the duties of his or her position or any substantially similar position due to a mental or physical impairment that can be expected to result in death or last for a continuous period of at least six (6) months, provided cancellation occurs by the later of the end of the taxable year of the Participant or the fifteenth (15<sup>th</sup>) day of the third (3<sup>rd</sup>) month following the date the Participant incurs the disability (as defined in this paragraph (iii)).

## **ARTICLE V**

### *Company Contributions*

5.1 Discretionary Company Contributions . The Participating Employer may, from time to time in its sole and absolute discretion, credit Company Contributions to any Participant in any amount determined by the Participating Employer. Such contributions will be credited to a Participant’s Separation from Service Account.

5.2 Vesting. Company Contributions described in Section 5.1, above, and the Earnings thereon, shall vest in accordance with the vesting schedule(s) established by the Committee at the time that the Company Contribution is made. The Participating Employer may, at any time, in its sole discretion, increase a Participant's vested interest in a Company Contribution. Company Contributions will become 100% vested upon the Participant's death or Disability while employed by the Company, and immediately prior to a Change in Control. The portion of a Participant's Accounts that remains unvested upon his or her Separation from Service after the application of the terms of this Section 5.2 shall be forfeited.

## ARTICLE VI

### *Benefits*

6.1 Benefits, Generally. A Participant shall be entitled to the following benefits under the Plan:

- (a) *Separation from Service Benefit*. Upon the Participant's Separation from Service for reasons other than death, he or she shall be entitled to a Separation from Service Benefit. The Separation from Service Benefit shall be equal to the vested portion of the Participant's Separation from Service Account and the unpaid balance of the Participant's Specified Date Accounts with respect to which payments have not yet commenced, based on the value of those Accounts as of the end of the calendar month immediately preceding the calendar month of distribution. Payment of the Separation from Service Benefit will be made no later than the end of the month following the month in which Separation from Service occurs, with the actual payment date determined in the sole discretion of the Committee. Notwithstanding the foregoing, if a Participant is a Specified Employee on the date of such Participant's Separation from Service, such distribution will be made or begin on the first day of the seventh calendar month following the calendar month in which the Separation from Service occurs to the extent necessary to avoid a "prohibited distribution" under Section 409A(a)(2)(B)(i) of the Code (with any amounts otherwise payable prior to such seventh calendar month instead paid on the first day of such seventh calendar month). If the Separation from Service Benefit is to be paid in the form of installments, any subsequent installment payments will be paid in accordance with the schedule applicable to such payments.
- (b) *Specified Date Benefit*. If the Participant has established one or more Specified Date Accounts, he or she shall be entitled to a Specified Date Benefit with respect to each such Specified Date Account. The Specified Date Benefit shall be equal to the vested portion of the Specified Date Account, based on the value of that Account as of the end of the month designated by the Participant at the time the Account was established. Payment of the Specified Date Benefit will be made or begin no later than the end of the month following the designated month, with the actual payment or commencement date determined in the sole discretion of the Committee.

- (c) *Death Benefit* . In the event of the Participant's death, his or her designated Beneficiary(ies) shall be entitled to a Death Benefit. The Death Benefit shall be equal to the vested portion of the Separation from Service Account and the unpaid balances of any Specified Date Accounts. The Death Benefit shall be based on the value of the Accounts as of the end of the month in which death occurred, with payment made no later than the end of the month following the month in which death occurs, with the actual payment date determined in the sole discretion of the Committee.

Each Participant may, pursuant to such procedures as the Committee may specify, designate one or more Beneficiaries in connection with the Plan. If a Participant is married or has a registered domestic partner and names someone other than his or her spouse or domestic partner, as applicable, as a primary Beneficiary with respect to any portion of his or her Accounts, spousal/partner consent shall be required to be provided in a form designated by the Committee, executed by such Participant's spouse/partner and returned to the Committee. A Participant may change or revoke a Beneficiary designation by delivering to the Committee a new designation (or revocation). Any designation or revocation shall be effective only if it is received in proper form by the Committee. However, when so received, the designation or revocation shall be effective as of the date the notice is executed, but without prejudice to any Employer on account of any payment made before the change is recorded. The last effective designation received by the Committee shall supersede all prior designations. If a Participant dies without having effectively designated a Beneficiary, or if no Beneficiary survives the Participant, the Death Benefit shall be payable (i) to his or her surviving spouse/domestic partner, or (ii) if the Participant is not survived by his or her spouse/domestic partner, to his or her estate. A former spouse/domestic partner shall have no interest under the Plan, as Beneficiary or otherwise, unless the Participant designates such person as a Beneficiary after dissolution of the marriage/partnership, except to the extent provided under the terms of a domestic relations order as described in Code Section 414(p)(1)(B).

- (d) *Unforeseeable Emergency Payments* . A Participant who experiences an Unforeseeable Emergency may submit a written request to the Committee to receive payment of all or any portion of his or her vested Accounts. Whether a Participant or Beneficiary is faced with an Unforeseeable Emergency permitting an emergency payment shall be determined by the Committee based on the relevant facts and circumstances of each case, but, in any case, a distribution on account of Unforeseeable Emergency may not be made to the extent that such emergency is or may be reimbursed through insurance or otherwise, by liquidation of the Participant's assets, to the extent the liquidation of such assets would not cause severe financial hardship, or by cessation of Deferrals under this Plan. If an emergency payment is approved by the Committee, the amount of the payment shall not exceed the amount reasonably necessary to satisfy the need, taking into account the additional compensation that is available to the Participant as the result of cancellation of deferrals to the Plan, including amounts necessary to pay any taxes or penalties that the Participant reasonably anticipates will result

from the payment. The amount of the emergency payment shall be subtracted first from the vested portion of the Participant's Separation from Service Account until depleted and then from the vested Specified Date Accounts, beginning with the Specified Date Account with the latest payment commencement date. Emergency payments shall be paid in a single lump sum within the ninety (90) day period following the date the payment is approved by the Committee.

- (e) *Disability Benefit* . In the event that a Participant becomes Disabled on or after the one-year anniversary of the Effective Date, he or she shall be entitled to a Disability Benefit. The Disability Benefit shall be equal to the vested portion of the Separation from Service Account and the unpaid balances of any Specified Date Accounts. The payment date for the Disability Benefit shall be no later than the end of the month following the calendar month in which the Committee determined that the Participant has become Disabled, with the actual payment date determined in the sole discretion of the Committee, and the Disability Benefit shall be based on the value of the vested (and, as applicable, unpaid) portion of the Accounts as of the last day of the calendar month in which the Committee makes a determination as to the Participant's Disability. In the event that a Participant becomes Disabled prior to the one-year anniversary of the Effective Date, then such Participant shall not be entitled to a Disability Benefit pursuant to this Section 6.1(e) and such Participant shall instead remain eligible to receive a Separation from Service Benefit, a Specified Date Benefit or a Death Benefit, as applicable, pursuant to the Plan.

## 6.2 Form of Payment .

- (a) *Separation from Service Benefit* . A Participant who is entitled to receive a Separation from Service Benefit shall receive payment of such benefit in a single lump sum, unless the Participant elects on his or her initial Compensation Deferral Agreement to have such benefit paid in annual installments, determined and paid in accordance with Section 6.2(g), over a period of two (2) to fifteen (15) years, as elected by the Participant.
- (b) *Specified Date Benefit* . The Specified Date Benefit shall be paid in a single lump sum, unless the Participant elects on the Compensation Deferral Agreement with which the account was established to have the Specified Date Account paid in annual installments, determined and paid in accordance with Section 6.2(g), over a period of two (2) to five (5) years, as elected by the Participant.

Notwithstanding any Specified Date election of a Participant, if a Participant incurs a Separation from Service, dies or becomes Disabled, in each case before distributions with respect to a Specified Date Account have commenced, such amounts shall be paid in accordance with the time and form of payment applicable to the Participant's Separation from Service Benefit, Death Benefit, or Disability Benefit (as applicable). With respect to Specified Date Account Balances that have commenced to be paid in installment payments prior to the date of the Separation from Service, death or Disability, such Specified Date

Accounts shall continue to be paid in accordance with the form of payment election applicable to the Specified Date Account.

- (c) *Death Benefit.* In the event of the Participant's death on or after the one-year anniversary of the Effective Date, his or her designated Beneficiary(ies) shall be entitled to a Death Benefit as set forth in Section 6.1(c). The Death Benefit shall be equal to the vested portion of the Participant's Separation from Service Account and the unpaid balances of any Specified Date Accounts and shall be payable in a single lump sum. In the event of the Participant's death before the one year anniversary of the Effective Date, a designated Beneficiary who is entitled to receive a Death Benefit shall receive payment of such benefit according to the Participant's Separation from Service Benefit election.
- (d) *Change in Control .* A Participant will receive his or her Separation from Service Benefit in a single lump sum payment equal to the unpaid balance of all of his or her Accounts if Separation from Service occurs within twenty-four (24) months following a Change in Control.

A Participant or Beneficiary receiving installment payments when a Change in Control occurs, will receive the remaining account balance in a single lump sum within 90 days following the Change in Control, with the actual payment date determined in the sole discretion of the Committee.

- (e) *Small Account Balances .* The Committee shall pay the value of the Participant's Accounts upon a Separation from Service in a single lump sum if the balance of such Accounts is not greater than the applicable dollar amount under Code Section 402 (g)(1)(B), provided the payment represents the complete liquidation of the Participant's interest in the Plan.
- (f) *Rules Applicable to Installment Payments .* If a Payment Schedule specifies installment payments, annual payments will be made beginning as of the payment commencement date for such installments and shall continue on each anniversary thereof until the number of installment payments specified in the Payment Schedule has been paid. The amount of each installment payment shall be determined by dividing (a) by (b), where (a) equals the Account Balance as of the Valuation Date and (b) equals the remaining number of installment payments.

For purposes of Article VII, installment payments will be treated as a single form of payment. If a lump sum equal to less than one hundred percent (100%) of the Separation from Service Account is paid, the payment commencement date for the installment form of payment will be the first (1<sup>st</sup>) anniversary of the payment of the lump sum.

- (g) *Disability Benefit.* A Participant who is entitled to receive a Disability Benefit shall receive payment of such benefit in a single lump sum.

6.3 Acceleration of or Delay in Payments . The Committee, in its sole and absolute discretion, may elect to accelerate the time or form of payment of a benefit owed to the



Participant hereunder, provided such acceleration is permitted under Treas. Reg. Section 1.409A-3(j)(4). The Committee may also, in its sole and absolute discretion, delay the time for payment of a benefit owed to the Participant hereunder, to the extent permitted under Treas. Reg. Section 1.409A-2(b)(7). If the Plan receives a domestic relations order (within the meaning of Code Section 414(p)(1)(B)) directing that all or a portion of a Participant's Accounts be paid to an "alternate payee," any amounts to be paid to the alternate payee(s) shall be paid in a single lump sum.

## **ARTICLE VII**

### *Modifications to Payment Schedules*

- 7.1 Participant's Right to Modify. A Participant may modify any or all of the alternative Payment Schedules with respect to an Account, consistent with the permissible Payment Schedules available under the Plan, provided such modification complies with the requirements of this Article VII.
- 7.2 Time of Election. The date on which a modification election is submitted to the Committee must be at least twelve (12) months prior to the date on which payment is scheduled to commence under the Payment Schedule in effect prior to the modification.
- 7.3 Date of Payment under Modified Payment Schedule. Except with respect to modifications that relate to the payment of a Death Benefit or a Disability Benefit, the date payments are to commence under the modified Payment Schedule must be no earlier than five (5) years after the date payment would have commenced under the original Payment Schedule. Under no circumstances may a modification election result in an acceleration of payments in violation of Code Section 409A.
- 7.4 Effective Date. A modification election submitted in accordance with this Article VII is irrevocable upon receipt by the Committee and becomes effective twelve (12) months after such date.
- 7.5 Effect on Accounts. An election to modify a Payment Schedule is specific to the Account or payment event to which it applies and shall not be construed to affect the Payment Schedules of any other Accounts.

## **ARTICLE VIII**

### *Valuation of Account Balances; Investments*

- 8.1 Valuation. Deferrals shall be credited to appropriate Accounts on the date such Compensation would have been paid to the Participant absent the Compensation Deferral Agreement. Company Contributions shall be credited to the Separation from Service Account at the times determined by the Committee. Valuation of Accounts shall be performed under procedures approved by the Committee.
- 8.2 Earnings Credit. Each Account will be credited with Earnings on each Business Day, based upon the Participant's investment allocation among a menu of investment options selected in advance by the Committee, in accordance with the provisions of this Article VIII ("investment allocation").

8.3 Investment Options. Investment options will be determined by the Committee. The Committee, in its sole discretion, shall be permitted to add or remove investment options from the Plan menu from time to time, provided that any such additions or removals of investment options shall not be effective with respect to any period prior to the effective date of such change. In addition, following a Change in Control, the Committee may add or remove an investment option, provided however, that (i) any decision to add or remove an investment option shall be made in good faith, and (ii) there shall at all times be no less than the number of investment options that existed immediately prior to the Change in Control.

8.4 Investment Allocations. A Participant's investment allocation constitutes a deemed, not actual, investment among the investment options comprising the investment menu. At no time shall a Participant have any real or beneficial ownership in any investment option included in the investment menu, nor shall the Participating Employer or any trustee acting on its behalf have any obligation to purchase actual securities as a result of a Participant's investment allocation. A Participant's investment allocation shall be used solely for purposes of adjusting the value of a Participant's Account Balances.

A Participant shall specify an investment allocation for each of his Accounts in accordance with procedures established by the Committee. Allocation among the investment options must be designated in increments of one percent (1%). The Participant's investment allocation will become effective on the same Business Day or, in the case of investment allocations received after a time specified by the Committee, the next Business Day.

A Participant may change an investment allocation on any Business Day, both with respect to future credits to the Plan and with respect to existing Account Balances, in accordance with procedures adopted by the Committee. Changes shall become effective on the same Business Day or, in the case of investment allocations received after a time specified by the Committee, the next Business Day, and shall be applied prospectively.

8.5 Unallocated Deferrals and Accounts. If the Participant fails to make an investment allocation with respect to an Account, such Account shall be invested in an investment option, the primary objective of which is the preservation of capital, as determined by the Committee.

## **ARTICLE IX**

### *Administration*

9.1 Plan Administration. This Plan shall be administered by the Committee which shall have discretionary authority to make, amend, interpret and enforce all appropriate rules and regulations for the administration of this Plan and to utilize its discretion to decide or resolve any and all questions, including but not limited to eligibility for benefits and interpretations of this Plan and its terms, as may arise in connection with the Plan. Claims for benefits shall be filed with the Committee and resolved in accordance with the claims procedures in Article XII.

- 9.2 Withholding. The Participating Employer shall have the right to withhold from any payment due under the Plan (or with respect to any amounts credited to the Plan) any taxes required by law to be withheld in respect of such payment (or credit). Withholdings with respect to amounts credited to the Plan shall be deducted from Compensation that has not been deferred to the Plan.
- 9.3 Indemnification. The Participating Employers shall indemnify and hold harmless each employee, officer, director, agent or organization, to whom or to which are delegated duties, responsibilities, and authority under the Plan or otherwise with respect to administration of the Plan, including, without limitation, the Committee and its agents, against all claims, liabilities, fines and penalties, and all expenses reasonably incurred by or imposed upon him or it (including but not limited to reasonable attorney fees) which arise as a result of his or its actions or failure to act in connection with the operation and administration of the Plan to the extent lawfully allowable and to the extent that such claim, liability, fine, penalty, or expense is not paid for by liability insurance purchased or paid for by the Participating Employer. Notwithstanding the foregoing, the Participating Employer shall not indemnify any person or organization if his or its actions or failure to act are due to gross negligence or willful misconduct or for any such amount incurred through any settlement or compromise of any action unless the Participating Employer consents in writing to such settlement or compromise.
- 9.4 Delegation of Authority. In the administration of this Plan, the Committee may, from time to time, employ agents and delegate to them such administrative duties as it sees fit, and may from time to time consult with legal counsel who shall be legal counsel to the Company and such other professional advisors as the Committee may determine.
- 9.5 Binding Decisions or Actions. The decision or action of the Committee in respect of any question arising out of or in connection with the administration, interpretation and application of the Plan and the rules and regulations thereunder shall be final and conclusive and binding upon all persons having any interest in the Plan.

## **ARTICLE X**

### *Amendment and Termination*

- 10.1 Amendment and Termination. The Company may at any time and from time to time amend the Plan or may terminate the Plan as provided in this Article X. Each Participating Employer may also terminate its participation in the Plan.
- 10.2 Amendments. The Company, by action taken by its Board of Directors, may amend the Plan at any time and for any reason, provided that any such amendment shall not reduce the vested Account Balances of any Participant accrued as of the date of any such amendment or restatement (as if the Participant had incurred a voluntary Separation from Service on such date) or reduce any rights of a Participant under the Plan or other Plan features with respect to Deferrals made prior to the date of any such amendment or restatement without the consent of the Participant. The Board of Directors of the Company may delegate to the Committee the authority to amend the Plan without the consent of the Board of Directors for the purpose of: (i) conforming the Plan to the

requirements of law; (ii) facilitating the administration of the Plan; (iii) clarifying provisions based on the Committee's interpretation of the document; and (iv) making such other amendments as the Board of Directors may authorize.

- 10.3 Termination. The Company, by action taken by its Board of Directors, may terminate the Plan and pay Participants and Beneficiaries their Account Balances in a single lump sum at any time, to the extent and in accordance with Treas. Reg. Section 1.409A-3(j)(4)(ix). If a Participating Employer terminates its participation in the Plan, the benefits of affected Employees shall be paid at the time provided in Article VI.
- 10.4 Accounts Taxable Under Code Section 409A. The Plan is intended to constitute a plan of deferred compensation that meets the requirements for deferral of income taxation under Code Section 409A. The Committee, pursuant to its authority to interpret the Plan, may sever from the Plan or any Compensation Deferral Agreement any provision or exercise of a right that otherwise would result in a violation of Code Section 409A.

## **ARTICLE XI**

### *Informal Funding*

- 11.1 General Assets. Obligations established under the terms of the Plan may be satisfied from the general funds of the Participating Employers, or a trust described in this Article XI. No Participant, spouse or Beneficiary shall have any right, title or interest whatever in assets of the Participating Employers. Nothing contained in this Plan, and no action taken pursuant to its provisions, shall create or be construed to create a trust of any kind, or a fiduciary relationship, between the Participating Employers and any Employee, spouse, or Beneficiary. To the extent that any person acquires a right to receive payments hereunder, such rights are no greater than the right of an unsecured general creditor of the Participating Employer.
- 11.2 Rabbi Trust. A Participating Employer may, in its sole discretion, establish a grantor trust, commonly known as a rabbi trust, as a vehicle for accumulating assets to pay benefits under the Plan. Payments under the Plan may be paid from the general assets of the Participating Employer or from the assets of any such rabbi trust. Payment from any such source shall reduce the obligation owed to the Participant or Beneficiary under the Plan.

## **ARTICLE XII**

### *Claims*

- 12.1 Filing a Claim. Any controversy or claim arising out of or relating to the Plan shall be filed in writing with the Committee which shall make all determinations concerning such claim. Any claim filed with the Committee and any decision by the Committee denying such claim shall be in writing and shall be delivered to the Participant or Beneficiary filing the claim (the "Claimant").
- (a) *In General*. Notice of a denial of benefits (other than Disability benefits) will be provided within ninety (90) days of the Committee's receipt of the Claimant's claim for benefits. If the Committee determines that it needs additional time to

review the claim, the Committee will provide the Claimant with a notice of the extension before the end of the initial ninety (90) day period. The extension will not be more than ninety (90) days from the end of the initial ninety (90) day period and the notice of extension will explain the special circumstances that require the extension and the date by which the Committee expects to make a decision.

- (b) *Contents of Notice* . If a claim for benefits is completely or partially denied, notice of such denial shall be in writing and shall set forth the reasons for denial in plain language. The notice shall: (i) cite the pertinent provisions of the Plan document; and (ii) explain, where appropriate, how the Claimant can perfect the claim, including a description of any additional material or information necessary to complete the claim and why such material or information is necessary. The claim denial also shall include an explanation of the claims review procedures and the time limits applicable to such procedures, including a statement of the Claimant's right to bring a civil action under Section 502(a) of ERISA following an adverse decision on review. In the case of a complete or partial denial of a Disability benefit claim, the notice shall provide a statement that the Committee will provide to the Claimant, upon request and free of charge, a copy of any internal rule, guideline, protocol, or other similar criterion that was relied upon in making the decision.
- (c) *Disability Benefits* . Notice of denial of Disability benefits will be provided within forty-five (45) days of the Committee's receipt of the Claimant's claim for Disability benefits. If the Committee determines that it needs additional time to review the Disability claim, the Committee will provide the Claimant with a notice of the extension before the end of the initial 45-day period. If the Committee determines that a decision cannot be made within the first extension period due to matters beyond the control of the Committee, the time period for making a determination may be further extended for an additional 30 days. If such an additional extension is necessary, the Committee shall notify the Claimant prior to the expiration of the initial 30-day extension. Any notice of extension shall indicate the circumstances necessitating the extension of time, the date by which the Committee expects to furnish a notice of decision, the specific standards on which such entitlement to a benefit is based, the unresolved issues that prevent a decision on the claim and any additional information needed to resolve those issues. A Claimant will be provided a minimum of 45 days to submit any necessary additional information to the Committee. In the event that a 30-day extension is necessary due to a Claimant's failure to submit information necessary to decide a claim, the period for furnishing a notice of decision shall be tolled from the date on which the notice of the extension is sent to the Claimant until the earlier of the date the Claimant responds to the request for additional information or the response deadline.

12.2 Appeal of Denied Claims . A Claimant whose claim has been completely or partially denied shall be entitled to appeal the claim denial by filing a written appeal with a

committee designated to hear such appeals (the "Appeals Committee"). A Claimant who timely requests a review of the denied claim (or his or her authorized representative) may review, upon request and free of charge, copies of all documents, records and other information relevant to the denial and may submit written comments, documents, records and other information relevant to the claim to the Appeals Committee. All written comments, documents, records, and other information shall be considered "relevant" if the information: (i) was relied upon in making a benefits determination; (ii) was submitted, considered or generated in the course of making a benefits decision regardless of whether it was relied upon to make the decision; or (iii) demonstrates compliance with administrative processes and safeguards established for making benefit decisions. The Appeals Committee may, in its sole discretion and if it deems appropriate or necessary, decide to hold a hearing with respect to the claim appeal.

- (a) *In General* . Appeal of a denied benefits claim (other than a Disability benefits claim) must be filed in writing with the Appeals Committee no later than sixty (60) days after receipt of the written notification of such claim denial. The Appeals Committee shall make its decision regarding the merits of the denied claim within sixty (60) days following receipt of the appeal (or within one hundred and twenty (120) days after such receipt, in a case where there are special circumstances requiring extension of time for reviewing the appealed claim). If an extension of time for reviewing the appeal is required because of special circumstances, written notice of the extension shall be furnished to the Claimant prior to the commencement of the extension. The notice will indicate the special circumstances requiring the extension of time and the date by which the Appeals Committee expects to render the determination on review. The review will take into account comments, documents, records and other information submitted by the Claimant relating to the claim without regard to whether such information was submitted or considered in the initial benefit determination.
- (b) *Contents of Notice* . If a benefits claim is completely or partially denied on review, notice of such denial shall be in writing and shall set forth the reasons for denial in plain language.

The decision on review shall set forth: (i) the specific reason or reasons for the denial; (ii) specific references to the pertinent Plan provisions on which the denial is based; (iii) a statement that the Claimant is entitled to receive, upon request and free of charge, reasonable access to and copies of all documents, records, or other information relevant (as defined above) to the Claimant's claim; and (iv) a statement describing any voluntary appeal procedures offered by the plan and a statement of the Claimant's right to bring an action under Section 502(a) of ERISA.

- (c) *Disability Benefits* . Appeal of a denied Disability benefits claim must be filed in writing with the Appeals Committee no later than 180 days after receipt of the written notification of such claim denial. The review shall be conducted by the Appeals Committee (exclusive of the person who made the initial adverse decision or such person's subordinate). In reviewing the appeal, the Appeals

Committee shall: (i) not afford deference to the initial denial of the claim, (ii) consult a medical professional who has appropriate training and experience in the field of medicine relating to the Claimant's disability and who was neither consulted as part of the initial denial nor is the subordinate of such individual, and (iii) identify the medical or vocational experts whose advice was obtained with respect to the initial benefit denial, without regard to whether the advice was relied upon in making the decision. The Appeals Committee shall make its decision regarding the merits of the denied claim within 45 days following receipt of the appeal (or within 90 days after such receipt, in a case where there are special circumstances requiring extension of time for reviewing the appealed claim). If an extension of time for reviewing the appeal is required because of special circumstances, written notice of the extension shall be furnished to the Claimant prior to the commencement of the extension. The notice will indicate the special circumstances requiring the extension of time and the date by which the Appeals Committee expects to render the determination on review. Following its review of any additional information submitted by the Claimant, the Appeals Committee shall render a decision on its review of the denied claim.

- (d) For the denial of a Disability benefit, the notice will also include a statement that the Appeals Committee will provide, upon request and free of charge: (i) any internal rule, guideline, protocol or other similar criterion relied upon in making the decision, (ii) any medical opinion relied upon to make the decision, and (iii) the required statement under Section 2560.503-1(j)(5)(iii) of the Department of Labor regulations.

- 12.3 Legal Action. A Claimant may not bring any legal action, including commencement of any arbitration, relating to a claim for benefits under the Plan unless and until the Claimant has followed the claims procedures under the Plan and exhausted his or her administrative remedies under such claims procedures.

If a Participant or Beneficiary prevails in a legal proceeding brought under the Plan to enforce the rights of such Participant or any other similarly situated Participant or Beneficiary, in whole or in part, the Participating Employer shall reimburse such Participant or Beneficiary for all legal costs, expenses, attorneys' fees and such other liabilities incurred as a result of such proceedings. If the legal proceeding is brought in connection with a Change in Control, or a "change in control" as defined in a rabbi trust described in Section 11.2, the Participant or Beneficiary may file a claim directly with the trustee for reimbursement of such costs, expenses and fees. For purposes of the preceding sentence, the amount of the claim shall be treated as if it were an addition to the Participant's or Beneficiary's Account Balance and will be included in determining the Participating Employer's trust funding obligation under Section 11.2.

- 12.4 Discretion of Appeals Committee. All interpretations, determinations and decisions of the Appeals Committee with respect to any claim shall be made in its sole discretion, and shall be final and conclusive.

### **ARTICLE XIII**

#### *General Provisions*

- 13.1 Anti-assignment Rule. No interest of any Participant, spouse or Beneficiary under this Plan and no benefit payable hereunder shall be assigned as security for a loan, and any such purported assignment shall be null, void and of no effect, nor shall any such interest or any such benefit be subject in any manner, either voluntarily or involuntarily, to anticipation, sale, transfer, assignment or encumbrance by or through any Participant, spouse or Beneficiary. Notwithstanding anything to the contrary herein, however, the Committee has the discretion to make payments to an alternate payee in accordance with the terms of a domestic relations order (as defined in Code Section 414(p)(1)(B)).
- 13.2 No Legal or Equitable Rights or Interest. No Participant or other person shall have any legal or equitable rights or interest in this Plan that are not expressly granted in this Plan. Participation in this Plan does not give any person any right to be retained in the service of the Participating Employer. The right and power of a Participating Employer to dismiss or discharge an Employee is expressly reserved. The Participating Employers make no representations or warranties as to the tax consequences to a Participant or a Participant's beneficiaries resulting from a deferral of income pursuant to the Plan.
- 13.3 No Employment Contract. Nothing contained herein shall be construed to constitute a contract of employment between an Employee and a Participating Employer.
- 13.4 Notice. Any notice or filing required or permitted to be delivered to the Committee under this Plan shall be delivered in writing, in person, or through such electronic means as is established by the Committee. Notice shall be deemed given as of the date of delivery or, if delivery is made by mail, as of the date shown on the postmark on the receipt for registration or certification. Written transmission shall be sent by certified mail to:

**OSI SYSTEMS, INC.  
ATTN: DIRECTOR OF HUMAN RESOURCES  
12525 CHADRON AVENUE  
HAWTHORNE, CA 90250**

Any notice or filing required or permitted to be given to a Participant under this Plan shall be sufficient if in writing or hand-delivered, or sent by mail to the last known address of the Participant.

- 13.5 Headings. The headings of Sections are included solely for convenience of reference, and if there is any conflict between such headings and the text of this Plan, the text shall control.
- 13.6 Invalid or Unenforceable Provisions. If any provision of this Plan shall be held invalid or unenforceable, such invalidity or unenforceability shall not affect any other provisions hereof and the Committee may elect in its sole discretion to construe such invalid or unenforceable provisions in a manner that conforms to applicable law or as if such provisions, to the extent invalid or unenforceable, had not been included.



- 13.7 Lost Participants or Beneficiaries. Any Participant or Beneficiary who is entitled to a benefit from the Plan has the duty to keep the Committee advised of his or her current mailing address. If benefit payments are returned to the Plan or are not presented for payment after a reasonable amount of time, the Committee shall presume that the payee is missing. The Committee, after making such efforts as in its discretion it deems reasonable and appropriate to locate the payee, shall stop payment on any uncashed checks and may discontinue making future payments until contact with the payee is restored.
- 13.8 Facility of Payment to a Minor. If a distribution is to be made to a minor, or to a person who is otherwise incompetent, then the Committee may, in its discretion, make such distribution: (i) to the legal guardian, or if none, to a parent of a minor payee with whom the payee maintains his or her residence; or (ii) to the conservator or committee or, if none, to the person having custody of an incompetent payee. Any such distribution shall fully discharge the Committee, the Company, and the Plan from further liability on account thereof.
- 13.9 Governing Law. To the extent not preempted by ERISA, the laws of the State of California shall govern the construction and administration of the Plan.

**IN WITNESS WHEREOF, the undersigned executed this Plan as of the 25th day of April, 2014, to be effective as of the Effective Date.**

**OSI Systems, Inc.**

By: /s/ Alan Edrick  
Alan Edrick  
Its: 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 15d-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 1, 2014

/s/ Deepak Chopra  
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Deepak Chopra  
Chief Executive Officer

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**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 15d-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 1, 2014

/s/ Alan Edrick  
Alan Edrick  
Chief Financial Officer

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**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of OSI Systems, Inc. (the "Company") on Form 10-Q for the quarter ended March 31, 2014, 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), as applicable, 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 the Report.

Date: May 1, 2014

/s/ Deepak Chopra

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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.

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**CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of OSI Systems, Inc. (the "Company") on Form 10-Q for the quarter ended March 31, 2014, 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) , as applicable, 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 the Report.

Date: May 1, 2014

/s/ Alan Edrick

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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 any 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.

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