OSI SYSTEMS INC
Form 10-Q
February 05, 2008

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

FORM 10-Q

(Mark one)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended December 31, 2007

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _________to _________

Commission File Number 0-23125

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

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

12525 Chadron Avenue
Hawthorne, California 90250
(Address of principal executive offices)
(310) 978-0516
(Registrant s telephone number, including area code)

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 þ No o

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 definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of February 1, 2008, there were 17,663,781 shares of the registrant s common stock outstanding.

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)

	June 30, 2007	December 31, 2007 (Unaudited)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 15,980	$ 14,128
Accounts receivable	140,483	150,754
Other receivables	5,770	4,670
Inventories	120,174	148,608
Deferred income taxes	20,265	18,365
Prepaid expenses and other current assets	11,967	16,307
Total current assets	314,639	352,832
Property and equipment, net	48,051	47,014
Goodwill	50,286	64,730
Intangible assets, net	28,476	27,606
Other assets	10,031	9,653
Total assets	$ 451,483	$ 501,835
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Bank lines of credit	$ 16,775	$ 13,509
Current portion of long-term debt	5,744	5,042
Accounts payable	60,524	100,449
Accrued payroll and employee benefits	17,905	19,975
Advances from customers	16,734	6,501
Accrued warranties	7,443	9,158
Deferred revenue	7,548	7,734
Other accrued expenses and current liabilities	23,225	16,432
Total current liabilities	155,898	178,800
Long-term debt	25,709	47,902
Deferred rent	5,174	5,243
Other long-term liabilities	8,675	11,534
Total liabilities	195,456	243,479
Minority interest	8,815	1,049
Commitment and contingencies (Note 8)		
Shareholders Equity:		

Preferred stock, no par value authorized, 10,000,000 shares; no shares issued or outstanding		
Common stock, no par value authorized, 100,000,000 shares; issued and outstanding, 17,086,989 and 17,488,924 shares at June 30,2007 and December 31, 2007, respectively	207,260	217,278
Retained earnings	31,450	29,525
Accumulated other comprehensive income	8,502	10,504
Total shareholders equity	247,212	257,307
Total liabilities and shareholders equity	$ 451,483	$ 501,835

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2006	**2007**	**2006**	**2007**
Revenues	$ 137,458	$ 164,194	$ 252,987	$ 295,207
Cost of goods sold	98,177	105,193	175,209	192,096
Gross profit	39,281	59,001	77,778	103,111
Operating expenses:				
Selling, general and administrative expenses	38,290	39,105	74,879	75,316
Research and development	11,215	11,725	22,034	21,454
Impairment, restructuring, and other charges	21,543	2,114	21,543	2,199
Total operating expenses	71,048	52,944	118,456	98,969
Income (loss) from operations	(31,767)	6,057	(40,678)	4,142
Other income (expense):				
Other income	74			
Interest income	95	113	236	232
Interest expense	(1,267)	(1,281)	(2,281)	(2,489)
Income (loss) before provision for income taxes and minority interest	(32,865)	4,889	(42,723)	1,885
Provision (benefit) for income taxes	(12,106)	1,721	(15,285)	666
Minority interest benefit	146	312	784	194
Net income (loss)	$ (20,613)	$ 3,480	$ (26,654)	$ 1,413
Earnings (loss) per share:				
Basic	$ (1.23)	$ 0.20	$ (1.60)	$ 0.08
Diluted	$ (1.23)	$ 0.20	$ (1.60)	$ 0.08

Shares used in per share calculation:				
Basic	16,747	17,302	16,708	17,237
Diluted	16,747	17,675	16,708	17,597

See accompanying notes to condensed consolidated financial statements.

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OSI SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(amounts in thousands)
(Unaudited)

	Six Months Ended December 31,	
	2006	**2007**
Cash flows from operating activities:		
Net income (loss)	$ (26,654)	$ 1,413
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	9,907	9,506
Stock based compensation expense	2,825	2,301
Provision for losses on accounts receivable	265	285
Minority interest in net loss of subsidiary	(992)	(194)
Equity in earnings of unconsolidated affiliates	(70)	(236)
Deferred income taxes	(15,128)	(2,450)
Non-cash impairment charges	21,543	
In-process research and development	561	
Other	66	(11)
Changes in operating assets and liabilities net of business acquisitions:		
Accounts receivable	(6,584)	(9,763)
Other receivables	1,588	1,249
Inventories	3,484	(28,384)
Prepaid expenses and other current assets	(1,937)	(5,286)
Accounts payable	3,783	24,017
Accrued payroll and related expenses	541	2,640
Advances from customers	946	(10,378)
Accrued warranties	(869)	1,691
Deferred revenue	(3,299)	(8)
Other accrued expenses and current liabilities	(2,607)	(966)
Net cash used in operating activities	(12,631)	(14,574)
Cash flows from investing activities:		
Proceeds from the sale of marketable securities	68	
Purchases of marketable securities	(7,746)	
Proceeds from the sale of property and equipment	147	95
Acquisition of property and equipment		(4,995)
Acquisition of businesses net of cash acquired	(23,950)	
Buyback of subsidiary stock		(659)
Acquisition of intangible and other assets	(1,273)	(812)
Net cash used in investing activities	(32,754)	(6,371)
Cash flows from financing activities:		

Net proceeds from (payments on) bank lines of credit		16,320		(3,306)
Proceeds from long-term debt		26,019		44,891
Payments on long-term debt		(317)		(23,197)
Payments on capital lease obligations		(342)		(578)
Proceeds from exercise of stock options, warrants and employee stock purchase plan		2,211		1,862
Net cash provided by financing activities		43,891		19,672
Effect of exchange rate changes on cash		(152)		(579)
Net decrease in cash and cash equivalents		(1,649)		(1,852)
Cash and cash equivalents-beginning of period		13,799		15,980
Cash and cash equivalents-end of period	$	12,150	$	14,128
Supplemental disclosure of cash flow information:				
Cash paid for interest	$	2,342	$	2,342
Cash paid for income taxes	$	2,352	$	1,751
Supplemental disclosure of non-cash investing activities:				
Equipment purchased under capital lease obligations	$	2,493		
Buyback of subsidiary stock with common stock			$	5,898
Buyback of subsidiary stock in accounts payable			$	15,146

See accompanying notes to condensed consolidated financial statements.

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OSI SYSTEMS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

Description of Business

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

The Company has three operating divisions: (a) Security, providing security inspection systems; (b) Healthcare, providing medical monitoring and anesthesia systems; and (c) Optoelectronics and Manufacturing, providing specialized electronic components for affiliated end-products divisions, as well as for external clients in the defense and aerospace markets, among others.

The Company s Security division designs, manufactures and markets security and inspection systems worldwide to end users primarily under the Rapiscan Systems trade name. Rapiscan Systems products are used for the non-intrusive inspection of baggage, cargo, vehicles and other objects for weapons, explosives, drugs and other contraband and to screen people. These systems are also used for the safe, accurate and efficient verification of cargo manifests for the purpose of assessing duties and monitoring the export and import of controlled materials. Rapiscan Systems products fall into four categories: baggage and parcel inspection, cargo and vehicle inspection, hold (checked) baggage screening and people screening.

The Company s Healthcare division designs, manufactures and markets patient monitoring, diagnostic cardiology and anesthesia systems worldwide to end users, primarily under the Spacelabs trade name. 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. The Company s Healthcare division also offers centralized cardiac safety core laboratory services in connection with clinical trials by or on behalf of pharmaceutical companies and clinical research organizations.

The Company s Optoelectronics and Manufacturing division designs, manufactures and markets optoelectronic devices and value-added manufacturing services worldwide for use in a broad range of applications, including aerospace and defense electronics, security and inspection systems, medical imaging and diagnostics, computed tomography, toll and traffic management systems, fiber optics, telecommunications, weapons simulation systems, gaming, office automation, computer peripherals and industrial automation. The Company sells optoelectronic devices primarily under the OSI Optoelectronics trade name and performs value-added manufacturing services primarily under the OSI Electronics trade name. This division provides products and services to original equipment manufacturers, 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 Accounting Principles Board Opinion No. 28, Interim Financial Reporting and the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of the Company s management, all adjustments, consisting of only normal and recurring adjustments, necessary for a fair presentation of the financial position and the results of operations for the periods presented have been included. These condensed consolidated financial statements and the accompanying notes should be read in conjunction with the audited condensed consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2007, filed with the Securities and Exchange Commission on September 13, 2007.

The results of operations for the three and six months ended December 31, 2007 are not necessarily indicative of the operating results to be expected for the full fiscal year or any future periods.

Spacelabs Healthcare Public Offering and Repurchase

In October 2005, Spacelabs Healthcare, Inc., a subsidiary comprising the business operations of the Company s Healthcare division, completed an initial public offering of approximately 20% of its total issued and outstanding common stock. The Spacelabs Healthcare shares traded under the ticker symbol SLAB on the AIM (formerly known as the Alternative Investment Market), a stock market administered by the London Stock Exchange. In the second quarter of fiscal 2007, the Company began repurchasing publicly-traded shares of Spacelabs Healthcare, increasing the Company s ownership to 84% as of June 30, 2007. By December 31, 2007, the Company increased its ownership in Spacelabs Healthcare to 100% repurchasing all remaining shares of Spacelabs Healthcare. During the six months ended December 31, 2007, the Company spent approximately $15.8 million in cash and issued 240,000 shares of the Company s common stock in exchange for the remaining outstanding Spacelabs Healthcare shares. At the time of issuance, the 240,000 shares of the Company s common stock had a fair value of $5.9 million. As of December 31, 2007, $15.1 million of the cash portion of the repurchase remained outstanding and is included in accounts payable in the condensed consolidated financial statements. Effective January 24, 2008, Spacelabs Healthcare shares no longer trade on the AIM.

Impairment of Long-Lived Assets

The Company tests goodwill for impairment in accordance with Statement of Financial Accounting Standards (SFAS) 142, Goodwill and Other Intangible Assets (SFAS 142). SFAS 142 requires that goodwill be tested for impairment at the reporting unit level at least annually and more frequently upon the occurrence of certain events. For purposes of SFAS 142, the Company has determined that it has five reporting units, consisting of the Security division, Optoelectronics and Manufacturing division and two reporting units within the Healthcare division. The Company tests goodwill for impairment annually in its second fiscal quarter using a two-step process. First, the Company determines if the carrying amount of any of the reporting units within each of its divisions exceeds its fair value. It uses a discounted cash flows method to make this determination for its Security and Optoelectronics and Manufacturing divisions and it uses a market value method for the reporting units within its Healthcare division (based on the market price of Spacelabs Healthcare common stock on the AIM). If these methods indicate a potential impairment of goodwill associated with any reporting unit, the Company then compares the implied fair value of the goodwill associated with the respective reporting unit to its carrying amount to determine if there is an impairment loss.

In accordance with SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets, the Company evaluates long-lived assets, including intangible assets other than goodwill, for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. An impairment is considered to exist if the total estimated future cash flows on an undiscounted basis are less than the carrying amount of the assets. If an impairment does exist, the Company measures the impairment loss and records it based on the discounted estimate of future cash flows. In estimating future cash flows, the Company groups assets at the lowest level for which there are identifiable cash flows that are largely independent of cash flows from other asset groups. The Company s estimate of future cash flows is based upon, among other things, certain assumptions about expected future operating performance, growth rates and other factors.

Per Share Computations

The Company computes basic earnings per share by dividing net income available to common shareholders 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 shareholders 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 or warrants under the treasury stock method. Stock options and warrants to purchase a total of 0.3 million shares of common stock for the three months and six months ended December 31, 2007, were not included in diluted earnings per share calculations because to do so would have been antidilutive. Stock options and warrants to purchase a total of 1.7 million and 2.0 million shares of common stock for the three months and six months ended December 31, 2006, respectively, were not included in diluted earnings per share calculations because to do so would have been antidilutive. The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

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	Three Months Ended December 31,		Six Months Ended December 31,	
	2006	2007	2006	2007
Net income (loss) available to common shareholders	$ (20,613)	$ 3,480	$ (26,654)	$ 1,413
Weighted average shares outstanding basic	16,747	17,302	16,708	17,237
Dilutive effect of stock options and warrants		373		360
Weighted average of shares outstanding diluted	16,747	17,675	16,708	17,597
Basic earnings (loss) per share	$ (1.23)	$ 0.20	$ (1.60)	$ 0.08
Diluted earnings (loss) per share	$ (1.23)	$ 0.20	$ (1.60)	$ 0.08

Comprehensive Income

Comprehensive income/ (loss) is computed as follows (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2006	2007	2006	2007
Net income / (loss)	$ (20,613)	$ 3,480	$ (26,654)	$ 1,413
Foreign currency translation adjustments	2,251	530	2,131	2,030
Minimum pension liability adjustment	(44)	1	(55)	(85)
Other	(39)		(26)	57
Comprehensive income / (loss)	$ (18,445)	$ 4,011	$ (24,604)	$ 3,415

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurements. This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It is effective for fiscal years beginning after November 15, 2007. The Company has not yet determined the impact that this statement will have on its condensed consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities- including an amendment of SFAS No. 115, (SFAS 159). SFAS 159 allows companies to elect to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been chosen are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company has not yet determined the impact that this statement will have on its condensed consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations, (SFAS 141(R)). SFAS 141(R) retains the fundamental requirements of the original pronouncement requiring that the purchase method be used for all business combinations. SFAS 141(R) defines the acquirer as the entity that obtains control of one or more businesses in the business combination, establishes the acquisition date as the date that the acquirer achieves control and requires the acquirer to recognize the assets acquired, liabilities assumed and any noncontrolling interest at their fair values as of the acquisition date. In addition, SFAS 141(R) requires expensing of acquisition-related and restructure-related costs, remeasurement of earn out provisions at fair value, measurement of equity securities issued for purchase at the date of close of the transaction and non-expensing of in-process research and development related intangibles. SFAS 141(R) is effective for the Company s business combinations for which the acquisition date is on or after July 1, 2009. The Company has not yet determined the impact that this statement will have on its condensed consolidated financial statements.

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In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51, (SFAS 160). SFAS 160 amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. It requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. This Statement establishes a single method of accounting for changes in a parent s ownership interest in a subsidiary that do not result in deconsolidation. SFAS No. 160 is effective for the Company s fiscal year beginning July 1, 2009. The Company has not yet determined the impact that this statement will have on its condensed consolidated financial statements.

2. Balance Sheet Details

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

	June 30, 2007	December 31, 2007
Accounts receivable		
Trade receivables	$ 138,960	$ 150,867
Receivables related to long term contracts unbilled costs and accrued profit on progress completed	3,525	2,558
Total	142,485	153,425
Less: allowance for doubtful accounts	(2,002)	(2,671)
Accounts receivable, net	$ 140,483	$ 150,754
Inventories, net		
Raw materials	$ 64,652	$ 71,119
Work-in-process	25,304	39,011
Finished goods	30,218	38,478
Total	$ 120,174	$ 148,608
Property and equipment		
Land	$ 6,277	$ 6,244
Buildings and leasehold improvements	16,596	17,570
Equipment and tooling	44,224	48,683
Furniture and fixtures	5,202	5,348
Computer equipment	17,240	15,522
Software	8,754	10,385
Total	98,293	$ 103,752
Less: accumulated depreciation and amortization	(50,242)	(56,738)
Property and equipment, net	$ 48,051	$ 47,014