VARIAN MEDICAL SYSTEMS INC
Form 10-Q
February 09, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended January 1, 2010

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 1-7598

VARIAN MEDICAL SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-2359345**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
3100 Hansen Way,	
Palo Alto, California	**94304-1030**
(Address of principal executive offices)	**(Zip Code)**

(650) 493-4000

(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 x 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 x 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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	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 x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 123,932,873 shares of common stock, par value $1 per share, outstanding as of January 29, 2010.

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FORM 10-Q for the Quarter Ended January 1, 2010

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

(In thousands, except per share amounts)	Three Months Ended January 1, 2010	Three Months Ended January 2, 2009
Revenues:		
Product	$ 410,197	$ 402,141
Service contracts and other	130,709	106,528
Total revenues	540,906	508,669
Cost of revenues:		
Product	237,369	233,280
Service contracts and other	62,520	56,432
Total cost of revenues	299,889	289,712
Gross margin	241,017	218,957
Operating expenses:		
Research and development	38,388	36,978
Selling, general and administrative	83,542	83,233
Total operating expenses	121,930	120,211
Operating earnings	119,087	98,746
Interest income	808	2,262
Interest expense	(1,104)	(953)
Earnings from continuing operations before taxes	118,791	100,055
Taxes on earnings	40,016	30,476
Earnings from continuing operations	78,775	69,579
Loss from discontinued operations, net of taxes		(782)
Net earnings	$ 78,775	$ 68,797
Net earnings per share - Basic		
Continuing operations	$ 0.64	$ 0.56
Discontinued operations	$	$

Net earnings per share	$ 0.64	$ 0.56
Net earnings (loss) per share - Diluted		
Continuing operations	$ 0.63	$ 0.56
Discontinued operations	$	$ (0.01)
Net earnings per share	$ 0.63	$ 0.55
Weighted average shares used in the calculation of:		
Net earnings per share - Basic	123,690	123,818
Net earnings per share - Diluted	125,061	125,167

See accompanying notes to the condensed consolidated financial statements.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except par values)	January 1, 2010	October 2, 2009 [1]
Assets		
Current assets:		
Cash and cash equivalents	$ 625,495	$ 553,529
Accounts receivable, net of allowance for doubtful accounts of $4,291 at January 1, 2010 and $4,347 at October 2, 2009	507,411	580,918
Inventories	350,845	321,861
Prepaid expenses and other current assets	95,534	71,751
Deferred tax assets	143,993	144,392
Total current assets	1,723,278	1,672,451
Property, plant and equipment, net	258,432	264,060
Goodwill	210,563	210,346
Other assets	165,721	161,391
Total assets	$ 2,357,994	$ 2,308,248
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 103,450	$ 116,093
Accrued expenses	275,427	304,402
Product warranty	50,728	50,823
Deferred revenues	154,795	130,588
Advance payments from customers	253,862	226,964
Short-term borrowings	4,296	4,445
Current maturities of long-term debt	9,010	9,005
Total current liabilities	851,568	842,320
Long-term debt	23,327	23,394
Other long-term liabilities	128,874	130,751
Total liabilities	1,003,769	996,465
Commitments and contingencies (Note 9)		
Stockholders equity:		
Preferred stock of $1 par value: 1,000 shares authorized; none issued and outstanding		
Common stock of $1 par value: 189,000 shares authorized; 124,357 and 125,281 shares issued and outstanding at January 1, 2010 and at October 2, 2009, respectively	124,357	125,281
Capital in excess of par value	521,208	516,478
Retained earnings	735,634	696,409
Accumulated other comprehensive loss	(26,974)	(26,385)

Total stockholders equity	1,354,225	1,311,783
Total liabilities and stockholders equity	$ 2,357,994	$ 2,308,248

(1) The condensed consolidated balance sheet as of October 2, 2009 was derived from audited financial statements as of that date, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

See accompanying notes to the consolidated financial statements.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)	Three Months Ended January 1, 2010	January 2, 2009
Cash flows from operating activities:		
Net earnings	$ 78,775	$ 68,797
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Share-based compensation expense	8,845	10,706
Tax benefits from exercises of share-based payment awards	2,257	2,956
Excess tax benefits from share-based compensation	(1,430)	(2,996)
Depreciation	11,008	8,586
Amortization of intangible assets	927	931
Deferred taxes	(2,439)	(1,944)
Provision for doubtful accounts receivable	557	423
Net change in fair value of derivatives and underlying commitments	(432)	346
(Income) loss on equity investment in affiliate	(448)	7
Loss on sale or disposal of assets	2,043	28
Other	(304)	(819)
Changes in assets and liabilities:		
Accounts receivable	68,670	10,926
Inventories	(39,700)	(44,958)
Prepaid expenses and other current assets	(14,547)	(3,626)
Accounts payable	(12,295)	(13,360)
Accrued expenses	(21,892)	14,434
Deferred revenues	24,207	16,800
Product warranty	145	(1,725)
Advance payments from customers	26,890	22,894
Other long-term liabilities	(170)	(3,844)
Net cash provided by operating activities	130,667	84,562
Cash flows from investing activities:		
Purchases of property, plant and equipment	(7,554)	(18,467)
Increase in cash surrender value of life insurance	(1,170)	(1,391)
Note repayment (receivable) from affiliate and other, net	(1,837)	169
Other, net	(5,119)	(2,428)
Net cash used in investing activities	(15,680)	(22,117)
Cash flows from financing activities:		
Repurchases of common stock	(55,172)	(71,541)
Proceeds from issuance of common stock to employees	8,782	4,491
Excess tax benefits from share-based compensation	1,430	2,996
Employees taxes withheld and paid for restricted stock	(347)	(285)
Repayments of bank borrowings	(62)	(57)
Net borrowings under line of credit agreements		25,000
Other	(60)	(64)

Net cash used in financing activities	(45,429)	(39,460)
Effects of exchange rate changes on cash and cash equivalents	2,408	2,580
Net increase in cash and cash equivalents	71,966	25,565
Cash and cash equivalents at beginning of period	553,529	397,306
Cash and cash equivalents at end of period	$ 625,495	$ 422,871

See accompanying notes to the condensed consolidated financial statements.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Varian Medical Systems, Inc. (VMS) and subsidiaries (collectively, the Company) designs, manufactures, sells and services equipment and software products for treating cancer with radiotherapy, stereotactic radiosurgery and brachytherapy. The Company also designs, manufactures, sells and services x-ray tubes for original equipment manufacturers; replacement x-ray tubes; and flat panel digital image detectors for filmless x-rays imaging in medical, dental, veterinary, scientific and industrial applications. It designs, manufactures, sells and services linear accelerators, digital image detectors, image processing software and image detection products for security and inspection purposes. The Company also develops, designs, manufacturers and services proton therapy products and systems for cancer treatment.

Basis of Presentation

The condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements and the accompanying notes are unaudited and should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company s Annual Report on Form 10-K for the year ended October 2, 2009 (the 2009 Annual Report). In the opinion of management, the condensed consolidated financial statements herein include adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company s financial position as of January 1, 2010 and October 2, 2009, results of operations for the three months ended January 1, 2010 and January 2, 2009, and cash flows for the three months ended January 1, 2010 and January 2, 2009. The results of operations for the three months ended January 1, 2010 are not necessarily indicative of the operating results to be expected for the full fiscal year or any future period.

Fiscal Year

The fiscal years of the Company as reported are the 52- or 53- week periods ending on the Friday nearest September 30. Fiscal year 2010 is the 52-week period ending October 1, 2010, and fiscal year 2009 was the 53-week period that ended on October 2, 2009. The fiscal quarter ended January 1, 2010 was a 13-week period and the fiscal quarter ended January 2, 2009 was a 14-week period.

Reclassifications

Certain financial statement items have been reclassified to conform to the current fiscal year s format. These reclassifications had no impact on previously reported net earnings.

Discontinued Operations

As discussed in Note 16 Discontinued Operations, the Company has classified the assets and liabilities of the scientific research instruments business (Research Instruments) of ACCEL Instruments GmbH (ACCEL, which has since changed its name to Varian Medical Systems Particle Therapy GmbH) as discontinued operations and presented its operating results as a discontinued operation in the Condensed Consolidated Statements of Earnings for all periods presented. Because amounts related to Research Instruments in the Condensed Consolidated Balance Sheets and the Condensed Consolidated Statements of Cash Flows were not material for any period presented, the Company has not segregated them from continuing operations. Unless noted otherwise, discussion in these notes pertains to the Company s continuing operations.

Principles of Consolidation

The consolidated financial statements include those of VMS and its subsidiaries. Intercompany balances, transactions, and stock holdings have been eliminated in consolidation.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

Subsequent Events

The Company has evaluated subsequent events through February 9, 2010, the date the Company filed its Quarterly Report on Form 10-Q for the quarter ended January 1, 2010.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Fair Value of Financial Instruments

The carrying amounts of the Company s financial instruments, including cash and cash equivalents, accounts receivable, net of allowance for doubtful accounts, accounts payable and short-term borrowings, approximate fair value due to their short maturities. The fair value of the Company s long-term debt was estimated to be $34.7 million at January 1, 2010 and $34.8 million at October 2, 2009. The estimated fair value of long-term debt was based on the then-current rates available to the Company for debt of similar terms and remaining maturities. The Company determined the estimated fair value amount by using available market information and commonly accepted valuation methodologies. However, considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, the fair value estimate presented herein is not necessarily indicative of the amount that the Company or holders of the instruments could realize in a current market exchange. The use of different assumptions and/or estimation methodologies may have a material effect on the estimated fair value.

Revenue Recognition

The Company s revenues are derived primarily from the sale of hardware and software products, and related services and contracts from the Company s Oncology Systems, X-ray Products, Security and Inspection Products (SIP) and Varian Particle Therapy businesses. The Company recognizes its revenues net of any value added or sales tax and net of sales discounts.

Hardware Products

Except as described below under Service Contracts and Other, the Company recognizes revenues for hardware products in accordance with Accounting Standard Codification (ASC) 605, when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable and collectability is reasonably assured. For an arrangement with multiple deliverables, the Company recognizes product revenues in accordance with ASC 605-25 and 985-605, with revenues allocated among the different elements. Except for government tenders, group purchases and orders with letters of credit, the Company typically requires its customers to provide a down payment prior to transfer of risk of loss of ordered products or prior to performance under service contracts. These down payments are recorded as Advance payments from customers in the Condensed Consolidated Balance Sheets.

For Oncology Systems and SIP hardware products with installation obligations, the Company recognizes as revenues a portion of the product purchase price upon transfer of risk of loss and defers revenue recognition on the portion associated with product installation until acceptance, provided that all other criteria for revenue recognition have been met. The portion deferred is the greater of the fair market value of the installation services for such products or the amount of payment contractually linked to the acceptance. However, when (a) all of the purchase price for the hardware product is conditioned upon acceptance, (b) the hardware product does not have value to the customer on a standalone basis or (c) there is no objective and reliable evidence of the fair value of the undelivered item, then the Company defers all revenues until acceptance in accordance with the treatment for delivered items under ASC 605-25.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

Installation of Oncology Systems and SIP hardware products involves the Company s testing of each product at its factory prior to the product s delivery to ensure that the product meets the Company s published specifications. Once these tests establish that the specifications have been met, the product is then disassembled and shipped to the customer s site as specified in the customer contract. Risk of loss is transferred to the customer either at the time of shipment or delivery, depending upon the shipping terms of the contract. At the customer s site, the product is reassembled, installed and retested in accordance with the Company s installation procedures to ensure and demonstrate compliance with the Company s published specifications for that product.

Under the terms of the Company s hardware sales contract, acceptance of a hardware product with installation obligations is deemed to have occurred upon the earliest of (i) completion of product installation and testing in accordance with the Company s standard installation procedures showing compliance with the Company s published specifications for that product, (ii) receipt by the Company of an acceptance form executed by the customer acknowledging installation and compliance with the Company s published specifications for that product, (iii) use by the customer of the product for any purpose after its delivery or (iv) six months after the delivery of the product to the customer by the Company. The contract allows for cancellation only by mutual agreement, thus the customer does not have a unilateral right to return the delivered hardware product.

The Company does not have installation obligations for x-ray tubes, digital image detectors, spare parts and certain hardware products in Oncology Systems and the SIP business. For the products that do not include installation obligations, the Company recognizes revenues upon the transfer of risk of loss, which is either at the time of shipment or delivery, depending upon the shipping terms of the contract, provided that all other revenue recognition criteria have been met.

Software Products

Except as described below under Service Contracts and Other, the Company recognizes revenues for software products in accordance with ASC 985-605. The Company recognizes license revenues when all of the following criteria have been met: persuasive evidence of an arrangement exists, the vendor s fee is fixed or determinable, collection of the related receivable is probable, delivery of the product has occurred and the Company has received from the customer an acceptance form acknowledging installation and substantial conformance with the Company s specifications (as set forth in the user manual) for such product, or upon verification of installation when customer acceptance is not required to be received, or upon the expiration of an acceptance period, provided that all other criteria for revenue recognition have been met. Revenues earned on software arrangements involving multiple elements are allocated to each element based on vendor-specific objective evidence of the fair value (VSOE), which is based on the price charged when the same element is sold separately. In instances when evidence of VSOE of all undelivered elements exists, but evidence does not exist for one or more delivered elements, revenues are recognized using the residual method. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue. Revenue allocated to maintenance and support is recognized ratably over the maintenance term (typically one year).

Installation of the Company s software products may involve a certain amount of customer-specific implementation to enable the software product to function within the customer s operating environment (*i.e.*, with the customer s information technology network and other hardware, with the customer s data interfaces and with the customer s administrative processes) and substantially in conformance with the Company s specifications (as set forth in the user manual) for such product. With these software products, customers do not have full use of the software (*i.e.*, functionality) until the software is installed as described above and functioning within the customer s operating environment. Therefore, the Company recognizes 100% of such software revenues upon receipt from the customer of the Company s acceptance form acknowledging installation and such substantial conformance, or upon verification of installation when the Company is not required to receive customer acceptance, or upon the expiration of an acceptance period, provided that all other criteria for revenue recognition have been met.

The Company does not have installation obligations for certain brachytherapy and SIP software products. For software products that do not include installation obligations, the Company recognizes revenues upon the transfer of risk of loss, which is either at the time of shipment or delivery, depending upon the shipping terms of the contract, provided that all other criteria for revenue recognition have been met.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

Service Contracts and Other

Revenues related to service contracts are recognized ratably over the period of the related contracts. Revenues related to services performed on a time-and-materials basis are recognized when they are earned and billable.

Revenues related to certain proton therapy commissioning service contracts and highly customized image detection systems are recognized under the percentage-of-completion method or the completed-contract method in accordance with contract accounting. Revenues recognized under the percentage-of-completion method are primarily based on contract costs incurred to date compared with total estimated contract costs. Estimated losses on contracts are charged to cost of sales in the period when the loss is identified.

Deferred Revenue

Deferred revenue includes (i) the amount equal to the greater of the fair value of the installation services for hardware products or the amount of the payment that is contractually linked to acceptance and (ii) the entire sale price applicable to products shipped but for which installation and/or final acceptance have not been completed. Deferred costs associated with deferred revenues are included in Inventories in the Condensed Consolidated Balance Sheets.

Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued new accounting standards for business combinations under ASC 805, which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. The new standards also establish disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. In April 2009, the FASB issued additional standards under ASC 805-20 to clarify initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The Company adopted the new standards related to business combinations under ASC 805 at the beginning of fiscal year 2010. The impact of the adoption of these new standards depends on the nature and extent of business combinations occurring on or after the beginning of fiscal year 2010. The Company did not acquire any business in the first quarter of fiscal year 2010.

In December 2007, the FASB established new accounting and reporting standards under ASC 810 for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent s ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. The new accounting standards under ASC 810 also establish disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. The Company adopted the new standards under ASC 810 at the beginning of fiscal year 2010. The adoption of these new standards under ASC 810 had no impact on the Company s consolidated financial position, results of operations or cash flows.

In November 2008, the FASB ratified an Emerging Issues Task Force (EITF) Issue, which clarifies the accounting for certain transactions and impairment considerations involving equity method investments. The Company adopted the new standards, which are included in ASC 323-10 at the beginning of fiscal year 2010. The adoption of this new standard did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In August 2009, the FASB issued an update to ASC 820. This Accounting Standards Update (ASU) No. 2009-5, *Measuring Liabilities at Fair Value* (ASU 2009-5) amends the provisions in ASC 820 related to the fair value measurement of liabilities and clarifies valuation techniques in circumstances in which a quoted price in an active market for the identical liability is not available. ASU 2009-5 is intended to reduce potential ambiguity in financial reporting when measuring the fair value of liabilities. The Company adopted ASU 2009-5 at the beginning of fiscal year 2010. The adoption of ASU 2009-5 concerns disclosure only and did not have an impact on the Company s consolidated financial position, results of operations or cash flows.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

In December 2008, the FASB issued new standards under ASC 715-20, which provides guidance on an employer s disclosure about plan assets of a defined benefit pension or other post-retirement plan and requires employers to disclose information about fair value measurements of plan assets. The new standards under ASC 715-20 will be effective for the Company as of the end of fiscal year 2010. The adoption of these new standards concerns disclosure only and the Company does not expect it to have an impact on the Company s consolidated financial position, results of operations or cash flows.

In June 2009, the FASB issued the consolidation guidance for variable-interest entities to replace the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable-interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable-interest entity that most significantly impact the entity s economic performance. These new standards will be effective for the Company in the first quarter of fiscal year 2011. The Company is currently assessing the potential impact, if any, these new standards may have on its consolidated financial position, results of operations and cash flows.

In October 2009, the FASB issued an update to ASC 605. This ASU No. 2009-13, *Multiple Deliverable Revenue Arrangements* (ASU 2009-13), provides guidance on whether multiple deliverables in a revenue arrangement exist, how the arrangement should be separated and how the consideration should be allocated. ASU 2009-13 eliminates the requirement to establish the fair value of undelivered products and services and instead provides for separate revenue recognition based upon management s estimate of the selling price for an undelivered item when there is no other means to determine the fair value of that undelivered item. ASU 2009-13 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted if the Company elects to adopt ASU No. 2009-14, *Certain Revenue Arrangements That Include Software Elements* (ASU 2009-14) concurrently. The Company is currently evaluating the potential impact of ASU 2009-13 on its consolidated financial position, results of operations and cash flows.

In October 2009, the FASB issued an update to ASC 985-605. This ASU 2009-14, amends the scope of the software revenue guidance in ASC 985-605 to exclude tangible products containing software components and non-software components that function together to deliver the tangible product s essential functionality. ASU 2009-14 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted if the Company elects to adopt ASU 2009-13 concurrently. The Company is currently evaluating the potential impact of ASU 2009-14 on its consolidated financial position, results of operations and cash flows.

2. BALANCE SHEET COMPONENTS:

The components of inventories were as follows:

(In millions)	January 1, 2010	October 2, 2009
Inventories:		
Raw materials and parts	$ 202.6	$ 183.1
Work-in-progress	47.0	54.7
Finished goods	101.2	84.1
Total inventories	$ 350.8	$ 321.9

The components of other long-term liabilities were as follows:

(In millions)	January 1, 2010	October 2, 2009
Long-term income taxes payable	$ 67.2	$ 67.8
Other	61.7	63.0
Total other long-term liabilities	$ 128.9	$ 130.8

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

The Other category of other long-term liabilities primarily consisted of accruals for environmental costs, accrued pension and post-retirement benefits, deferred income tax liabilities and deferred rental income.

3. FAIR VALUE

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. There is a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company s financial assets and liabilities are valued using Level 1 and Level 2 inputs. Level 1 instrument valuations are obtained from quotes for transactions in active exchange markets involving identical assets. Level 2 instrument valuations include valuations obtained from quoted prices for identical assets in markets that are not active. In addition, the Company has elected to use the income approach to value its derivative instruments using standard valuation techniques and Level 2 inputs, such as currency spot rates, forward points and credit default swap spreads. The Company s derivative instruments are short-term in nature, typically one month to twelve months in duration. As of January 1, 2010, the Company did not have any financial assets or liabilities without observable market values that would require a high level of judgment to determine fair value (Level 3 instruments).

Effective October 3, 2009, the Company adopted the provisions of ASC 820 for nonfinancial assets and liabilities and the adoption did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

The Company has segregated all assets and liabilities that are measured at fair value on a recurring basis (at least annually) into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the measurement date in the table below.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

Assets/Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the Company s assets that are measured at fair value on a recurring basis. There were no liabilities that were measured at fair value as of January 1, 2010 and October 2, 2009.

	Fair Value Measurement Using			
Type of Instruments (In millions)	**Quoted Prices in Active Markets for Identical Instruments (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Balance**
Assets at January 1, 2010:				
Money market funds	$ 58.7	$	$	$ 58.7
Derivative assets		1.6		1.6
Total assets measured at fair value	$ 58.7	$ 1.6	$	$ 60.3
Assets at October 2, 2009:				
Money market funds	$ 85.0	$	$	$ 85.0
Total assets measured at fair value	$ 85.0	$	$	$ 85.0

	Fair Value Measurement Using			
Line Item in Condensed Consolidated Balance Sheet (In millions)	**Quoted Prices in Active Markets for Identical Instruments (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Balance**
Assets at January 1, 2010:				
Cash and cash equivalents	$ 57.6	$	$	$ 57.6
Prepaid expenses		1.6		1.6
Other assets	1.1			1.1
Total assets measured at fair value	$ 58.7	$ 1.6	$	$ 60.3

Assets at October 2, 2009:			
Cash and cash equivalents	$ 84.0	$	$ 84.0
Other assets	1.0		1.0
Total assets measured at fair value	$ 85.0	$	$ 85.0

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

4. GOODWILL AND INTANGIBLE ASSETS

The following table reflects the gross carrying amount and accumulated amortization of the Company s intangible assets included in Other assets in the Condensed Consolidated Balance Sheets as follows:

(In millions)	January 1, 2010	October 2, 2009
Intangible Assets:		
Acquired existing technology	$ 20.8	$ 20.8
Patents, licenses and other	18.5	15.2
Customer contracts and supplier relationship	10.4	10.4
Accumulated amortization	(38.1)	(37.2)
Net carrying amount	$ 11.6	$ 9.2

Amortization expense for intangible assets was $0.9 million and $0.9 million for the three months ended January 1, 2010 and January 2, 2009, respectively. The Company estimates amortization expense on a straight-line basis for the remaining nine months of fiscal year 2010, fiscal years 2011 through 2014 and thereafter, to be as follows (in millions): $2.5, $2.7, $1.9, $1.4, $0.6 and $2.5, respectively.

The following table reflects the activity of goodwill by reportable operating segment for the three months ended January 1, 2010:

(In millions)	Oncology Systems	X-ray Products	Other	Total
Balance at October 2, 2009	$ 126.7	$ 2.7	$ 80.9	$ 210.3
Payment or accrual of contingent consideration		1.5		1.5
Foreign currency translation adjustments			(1.2)	(1.2)
Balance at January 1, 2010	$ 126.7	$ 4.2	$ 79.7	$ 210.6

5. RELATED PARTY TRANSACTIONS

In fiscal years 1999 and 2000, VMS invested a total of $5 million in a three member consortium for a 20% ownership interest in dpiX Holding LLC (dpiX Holding), which in turn invested $25 million for an 80.1% ownership interest in dpiX LLC (dpiX), a supplier of amorphous silicon based thin-film transistor arrays (flat panels) for the Company s X-ray Products digital image detectors and for its Oncology Systems On-Board Imager® (OBI), and PortalVision™ imaging products. VMS had the right to appoint one manager of the five person board of managers. In accordance with the dpiX Holding agreement, net losses were to be allocated to the three members, in succession, until their capital accounts equaled zero, then to the three members in accordance with their ownership interests. The dpiX Holding agreement also provided that net profits were to be allocated to the three members, in succession, until their capital accounts equaled the net losses previously allocated, then to the three members in accordance with their ownership interests.

In September 2004, VMS acquired another member s 20% ownership interest in dpiX Holding for $1 million. As a result, VMS has the right to appoint two managers of the five person board of managers and its ownership interest in dpiX Holding increased to 40% with the remaining 60% being held by the other original member. When VMS acquired this additional 20% ownership interest, the capital account of the selling

member was nearly zero because it was the first in the consortium to be allocated losses. As a result, when dpiX Holding recorded net profits after VMS acquired the additional 20% ownership interest, VMS was the first to be allocated net profits to recover previously allocated losses.

The investment in dpiX Holding is accounted for under the equity method of accounting. When VMS recognizes its share of net profits or losses of dpiX Holding, profits in inventory purchased from dpiX are eliminated until realized by VMS. VMS recorded a gain on the equity investment in dpiX Holding of $0.5 million in the three months ended January 1, 2010 and a loss of $7,000 in the three months ended January 2, 2009. Income and losses on the equity investment in dpiX Holding are included in Selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings.

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The member that owned the other 19.9% ownership interest in dpiX had the right to sell back to dpiX on dpiX s last business day in December 2004, 2005 and 2006, cumulatively all of that member s ownership interest for $5 million if dpiX had not become a publicly traded company as of the last business day in December 2004. In December 2004, that member exercised its right to sell back to dpiX its 19.9% ownership interest. On each of December 22, 2005 and December 24, 2004, dpiX repurchased from that member a 7.96% ownership interest for a payment of $2 million (in aggregate, a 15.92% interest for $4 million). On December 22, 2006, dpiX repurchased the remaining 3.98% ownership interest for $1 million and VMS s indirect ownership interest in dpiX increased to 40%.

In February 2008, VMS agreed to loan $1.6 million to dpiX, with the loan bearing interest at prime plus 1% per annum. The principal balance is due and payable to VMS in twelve equal quarterly installments beginning in January 2010; interest is payable in full according to a quarterly schedule which began in April 2008; and the entire principal balance, together with accrued and unpaid interest thereon and all other related amounts payable thereunder, is due and payable on October 10, 2012. The note receivable from dpiX was $1.6 million at both January 1, 2010 and October 2, 2009. The current portion of the note receivable was included in Prepaid expense and other current assets and the long-term portion was included in Other Assets in the Condensed Consolidated Balance Sheets.

In February 2009, VMS agreed to loan an additional $14 million to dpiX in four separate installments over a period through the first half of fiscal year 2010. The loan bears interest at prime plus 1% per annum. The principal balance is due and payable to VMS in four installments beginning in December 2011; interest is payable in full according to a quarterly schedule which began in April 2009; and the entire principal balance, together with accrued and unpaid interest thereon and all other related amounts payable thereunder, is due and payable on September 10, 2012. As of January 1, 2010, VMS had loaned $8.8 million to dpiX under this loan agreement. The current portion of the note receivable was included in Prepaid expense and other current assets and the long-term portion was included in Other Assets in the Condensed Consolidated Balance Sheets.

In March 2006, VMS and the other member of dpiX Holding agreed to invest an aggregate $92 million in dpiX Holding, with each member s contribution based on its percentage ownership interest in dpiX Holding, for dpiX to acquire and construct a manufacturing facility in Colorado to increase its production capacity. As of January 1, 2010 and October 2, 2009, VMS s contribution of $36.8 million to dpiX Holding for the Colorado manufacturing facility was included in Other assets in the Condensed Consolidated Balance Sheets.

During the three months ended January 1, 2010 and January 2, 2009, the Company purchased glass transistor arrays from dpiX totaling approximately $13.1 million and $7.8 million, respectively. These purchases of flat panels are included as a component of Inventory in the Condensed Consolidated Balance Sheets and Cost of revenues - product in the Condensed Consolidated Statements of Earnings for these periods.

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6. PRODUCT WARRANTY

The following table reflects the changes in the Company s accrued product warranty during the three months ended January 1, 2010 and January 2, 2009:

	Three Months Ended	
(In millions)	January 1, 2010	January 2, 2009
Accrued product warranty, at beginning of period	$ 50.8	$ 51.1
Charged to cost of revenues	12.5	11.2
Actual product warranty expenditures	(12.6)	(13.3)
Accrued product warranty, at end of period	$ 50.7	$ 49.0

7. CREDIT FACILITY

In July 2007, VMS entered into a credit agreement with Bank of America, N.A. (BofA) providing for an unsecured revolving credit facility that enabled the Company to borrow and have outstanding at any given time a maximum of $100 million (the BofA Credit Facility). On November 10, 2008, VMS amended and restated the BofA Credit Facility to increase the credit facility to $150 million and collateralize a portion of the credit facility with a pledge of stock of certain of the VMS s present and future subsidiaries that are deemed to be material subsidiaries. As of January 1, 2010, VMS has pledged to BofA 65% of the voting shares that it holds in Varian Medical Systems Nederland B.V., a wholly-owned subsidiary.

On July 14, 2009, the Company further amended and restated the credit facility (the Amended BofA Credit Facility) to enable VMS s Japanese subsidiary (VMS KK) to borrow up to 2.7 billion Japanese Yen as part of the overall credit facility (the Japanese Line of Credit). At any time amounts are outstanding under the Japanese Line of Credit, the full borrowing capacity is deemed committed for use in Japan and therefore the maximum amount VMS can otherwise borrow under the Amended BofA Credit Facility will be reduced by $30 million to $120 million. VMS guarantees the payment of the outstanding balance under the Japanese Line of Credit.

The Amended BofA Credit Facility may be used for working capital, capital expenditures, permitted acquisitions and other lawful corporate purposes. Borrowings under the Japanese Line of Credit can be used by VMS KK for refinancing certain intercompany debts, working capital, capital expenditures and other lawful corporate purposes. Borrowings under the Amended BofA Credit Facility (outside of the Japanese Line of Credit) accrue interest either (i) based on the London Inter Bank Offered Rate (LIBOR) plus a margin of 1.25% to 1.50% based on a leverage ratio involving funded indebtedness and earnings before interest, taxes, depreciation and amortization (EBITDA), or (ii) based upon a base rate of either the federal funds rate plus 0.5% or BofA s announced prime rate, whichever is greater, minus a margin of 0.5% to 0% based on a leverage ratio involving funded indebtedness and EBITDA, depending upon the Company s instructions to BofA. The Company may select borrowing periods of one, two, three or six months for advances based on the LIBOR rate. Interest rates on advances based on the base rate are adjustable daily. Under the Amended BofA Credit Facility, the Company paid commitment fees at an annual rate of 0.2% to 0.3% based on a leverage ratio involving funded indebtedness and EBITDA. Borrowings under the Japanese Line of Credit accrue interest at the basic loan rate announced by the Bank of Japan plus a margin of 1.25% to 1.50% based on a leverage ratio involving funded indebtedness and EBITDA. The Amended BofA Credit Facility will expire, if not extended by mutual agreement of VMS and BofA, on November 10, 2011. The Japanese Line of Credit will expire on November 10, 2010.

As of January 1, 2010, there was no outstanding balance under the Amended BofA Credit Facility other than $4.3 million outstanding under the Japanese Line of Credit with a weighted average interest rate of 1.55%. As of October 2, 2009, there was no outstanding balance under the Amended BofA Credit Facility other than $4.4 million outstanding under the Japanese Line of Credit with a weighted average interest rate of

1.55%. Up to $25 million of these facilities could also be used to support letters of credit issued on behalf of the Company, of which none were outstanding as of January 1, 2010 and October 2, 2009.

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The Amended BofA Credit Facility contains customary affirmative and negative covenants for facilities of this type. The Company has also agreed to maintain certain financial covenants relating to (i) leverage ratios involving funded indebtedness and EBITDA, (ii) liquidity and (iii) consolidated assets. For all periods presented, the Company was in compliance with all covenants.

8. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company measures all derivatives at fair value on the Condensed Consolidated Balance Sheets. The accounting for gains or losses resulting from changes in the fair value of those derivatives depends upon the use of the derivative and whether it qualifies for hedge accounting. Changes in the fair value of derivatives that do not qualify for hedge accounting treatment must be recognized in earnings, together with elements excluded from effectiveness testing and the ineffective portion of a particular hedge. The Company s derivative instruments are recorded at their fair value in Prepaid expenses and other current assets and Accrued expenses on the Company s Condensed Consolidated Balance Sheets.

The fair values of derivative instruments reported on the Company s Condensed Consolidated Balance Sheet were as follows:

	Asset Derivatives			Liability Derivatives		
(In millions)	Balance Sheet Location	January 1, 2010 Fair Value	October 2, 2009 Fair Value	Balance Sheet Location	January 1, 2010 Fair Value	October 2, 2009 Fair Value
Derivative designated as hedging instruments:						
Foreign exchange forward contracts	Prepaid Expenses	$ 1.6	$	Accrued liabilities	$	$
Total derivatives		$ 1.6	$		$	$

See Note 3, Fair Value and Valuation of Derivative Instruments under Critical Accounting Estimates in Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations regarding valuation of the Company s derivative instruments. Also see Note 1, Significant Accounting Policies to the Consolidated Financial Statements of the Company s 2009 Annual Report regarding credit risk associated with the Company s derivative instruments.

Cash Flow Hedging Activities

The Company has many transactions denominated in foreign currencies and addresses certain of those financial exposures through a risk management program that includes the use of derivative financial instruments. The Company sells products throughout the world, often in the currency of the customer s country, and may hedge certain of the larger foreign currency transactions when they are not transacted in the subsidiaries functional currency. These foreign currency sales transactions are hedged using forward exchange contracts. The Company may use other derivative instruments in the future. The Company enters into foreign currency forward exchange contracts primarily to reduce the effects of fluctuating foreign currency exchange rates. The Company does not enter into forward exchange contracts for speculative or trading purposes. The forward exchange contracts range from one to twelve months in maturity. As of January 1, 2010, the Company did not have any forward exchange contracts with an original maturity greater than twelve months.

The hedges of foreign currency denominated forecasted revenues are accounted for in accordance with ASC 815, pursuant to which the Company has designated its hedges of forecasted foreign currency revenues as cash flow hedges. For derivative instruments that are designated and qualify as cash flow hedges under ASC 815, the Company formally documents for each derivative contract at the hedge s inception the relationship between the hedging instrument (forward contract) and hedged item (forecasted foreign currency revenues), the nature of the risk being hedged, as well as its risk management objective and strategy for undertaking the hedge. The Company records the effective portion of the gain or loss on the derivative instrument in Accumulated other comprehensive income (loss) and reclassifies these amounts into Revenues in the

period during

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which the hedged transaction is recognized in earnings. The Company assesses hedge effectiveness both at the onset of the hedge and on an ongoing basis using regression analysis. The Company measures hedge ineffectiveness by comparing the cumulative change in the fair value of the hedge contract with the cumulative change in the fair value of the hedged item. The Company recognizes any ineffective portion of the hedge in Revenues, and amounts not included in the assessment of effectiveness in Cost of revenues in the Condensed Consolidated Statements of Earnings. During the three months ended January 1, 2010 and January 2, 2009, there were no material gains or losses due to hedge ineffectiveness of cash flow hedges and the Company did not discontinue any cash flow hedges that had a material impact on the Company s results of operations. At the inception of the hedge, the Company assesses whether the likelihood of meeting the forecasted cash flow is highly probable. As of January 1, 2010, all forecasted cash flows were still probable to occur. As of January 1, 2010, net unrealized gain on derivative instruments of $1.1 million, before tax, was included in Accumulated other comprehensive income (loss), and is expected to be reclassified to net earnings over the next twelve months.

The Company had the following outstanding foreign exchange forward contracts that were entered into to hedge forecasted revenues:

(In millions)	Notional Value Sold January 1, 2010
Euro	$ 29.6
Japanes yen	25.3
	$ 54.9

The following table presents the amounts, before tax, recognized in accumulated other comprehensive income (loss) and in the Condensed Consolidated Statements of Earnings that are related to the effective portion of the foreign exchange forward contracts designated as cash flow hedges:

	Gain (Loss) Recognized in Other Comprehensive Income (Effective Portion) Three Months Ended		Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income	Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Net Earnings (Effective Portion) Three Months Ended	
(in millions)	January 1, 2010	January 2, 2009	into Net Earnings (Effective Portion)	January 1, 2010	January 2, 2009
Foreign exchange contracts	$ 1.2	$ 3.7	Revenues	$	$ 1.2

For the three months ended January 1, 2010 and January 2, 2009, there were no amounts recognized in the Condensed Consolidated Statements of Earnings that are related to (i) the ineffective portion of the cash flow hedges and (ii) the amount excluded from effectiveness testing of the cash flow hedges.

Balance Sheet Hedging Activities

The Company also hedges balance sheet exposures from its various subsidiaries and business units, where the U.S. dollar is the functional currency. The Company enters into foreign currency forward exchange contracts to minimize the short-term impact of foreign currency fluctuations on monetary assets and liabilities denominated in currencies other than the U.S. dollar functional currency. The foreign currency

forward exchange contracts are short term in nature, typically with maturity of approximately one month, and are based on the net forecasted balance sheet exposure. These hedges of foreign-currency-denominated assets and liabilities do not qualify for hedge accounting treatment and are not designed as hedging instruments under ASC 815. For derivative instruments not designated as hedging instruments, changes in their fair values are recognized in Selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings. Changes in the

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values of these hedging instruments are offset by changes in the values of foreign currency denominated assets and liabilities. Variations from the forecasted foreign currency assets or liabilities, coupled with a significant currency movement, may result in a material gain or loss if the hedges are not effectively offsetting the change in value of the foreign currency asset or liability. Other than foreign exchange hedging activities, the Company has no other free-standing or embedded derivative instruments.

The Company had the following outstanding foreign exchange forward contracts that were entered into to hedge balance sheet exposures from its various foreign subsidiaries and business units:

	At January 1, 2010	
(In millions)	**Notional Value Sold**	**Notional Value Purchased**
Australian dollar	$ 7.8	$
Canadian dollar	10.5	
Danish krone		1.7
Euro	130.6	
Indian rupee	3.6	
Japanese yen	57.7	
Norwegian krone	0.3	
Swedish krona	2.1	5.9
Swiss franc		57.6
Totals	$ 212.6	$ 65.2

The following table presents the gains (losses) recognized in the Condensed Consolidated Statements of Earnings related to the foreign currency forward exchange contracts that are not designated as hedging instruments under ASC 815.

	Amount of Gain or (Loss) Recognized in Net Earnings on Derivative Three Months Ended	
Location of Gain or (Loss) Recognized in Income on Derivative		
(In millions)	**January 1, 2010**	**January 2, 2009**
Selling, general and administrative expenses	$ 3.6	$ 7.9

The gains (losses) on these derivative instruments were significantly offset by the gains (losses) resulting from the remeasurement of monetary assets and liabilities denominated in certain currencies other than the U.S. dollar functional currency.

Contingent Features

Certain of the Company s derivative instruments are subject to a master netting agreement which contains provisions that require the Company, in the event of a default, to settle the outstanding contracts in net liability positions by making settlement payments in cash or by setting off amounts owed to the counterparty against any credit support or collateral held by the counterparty. The counterparty s right of set-off is not limited to the derivative instruments and applies to other rights held by the counterparty. Pursuant to the master netting agreement, an event of

default includes the Company s failure to pay the counterparty under the derivative instruments, voluntary or involuntary bankruptcy, the Company s failure to repay an aggregate of $25 million or more in debts, and deterioration of creditworthiness of the surviving entity when the Company merges or transfers its assets or liabilities to another entity. As of January 1, 2010 and October 2, 2009, the Company did not have significant outstanding derivative instruments with credit-risk-related contingent features that were in a net liability position.

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9. COMMITMENTS AND CONTINGENCIES

Commitments

In October 2008, VMS consummated an agreement with Varian, Inc. (VI), under which VI would surrender its sublease of a building containing approximately 210,000 square feet of floor space and the related leasehold interest for the land. The term of this sublease expires in the year 2056. This building, which is located adjacent to the Company s corporate headquarters in Palo Alto, California, is intended to support the growth of the Company s operations and its longer term objective of co-locating certain of its operations. Pursuant to this agreement, VI agreed to surrender the space in the building to the Company over a period which began in October 2008 and which ends in June 2010 and the Company agreed to pay VI an aggregate of $21 million in cash and assume the obligations of sublessor under a below-market rate sublease to a third party for a portion of the building. As of January 1, 2010, $5 million had been paid to VI pursuant to this agreement and the remaining $16 million will be payable in June 2010.

Environmental Remediation Liabilities

The Company s operations and facilities, past and present, are subject to environmental laws, including laws that regulate the handling, storage, transport and disposal of hazardous substances. Certain of those laws impose cleanup liabilities under certain circumstances. In connection with those laws and certain of the Company s past and present operations and facilities, the Company oversees various environmental cleanup projects and also reimburses certain third parties for cleanup activities. Those include facilities sold as part of the Company s electron devices business in 1995 and thin film systems business in 1997. In addition, the U.S. Environmental Protection Agency (EPA) or third parties have named the Company as a potentially responsible party under the amended Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA), at sites to which the Company or the facilities of the sold businesses were alleged to have shipped waste for recycling or disposal (the CERCLA sites). In connection with the CERCLA sites, the Company to date has been required to pay only modest amounts as its contributions to cleanup efforts. Under the agreement that governs the spin-offs of VI and Varian Semiconductor Equipment Associates, Inc. (VSEA), VI and VSEA are each obligated to indemnify the Company for one-third of the environmental cleanup costs associated with corporate, discontinued or sold operations prior to the spin-offs (after adjusting for any insurance proceeds or tax benefits received by the Company), as well as fully indemnify the Company for other liabilities arising from the operations of the business transferred to it as part of the spin-offs.

The Company spent $0.3 million and $0.2 million (net of amounts borne by VI and VSEA) during the three months ended January 1, 2010 and January 2, 2009, respectively, on environmental cleanup costs, third-party claim costs, project management costs and legal costs.

Inherent uncertainties make it difficult to estimate the likelihood of the cost of future cleanup, third-party claims, project management and legal services for the CERCLA sites and one of the Company s past facilities. Nonetheless, as of January 1, 2010, the Company estimated that, net of VI s and VSEA s indemnification obligations, future costs associated with the CERCLA sites and this facility would range in total from $2.8 million to $7.1 million. The time frames over which these cleanup project costs are estimated vary, ranging from 1 year up to 30 years as of January 1, 2010. Management believes that no amount in that range is more probable of being incurred than any other amount and therefore accrued $2.8 million for these cleanup projects as of January 1, 2010. The accrued amount has not been discounted to present value due to the uncertainties that make it difficult to develop a single best estimate.

The Company believes it has gained sufficient knowledge to better estimate the scope and cost of monitoring, cleanup and management activities for its other past and present facilities. This, in part, is based on agreements with other parties and also cleanup plans approved by or completed in accordance with the requirements of the governmental agencies having jurisdiction. As of January 1, 2010, the Company estimated that the Company s future exposure, net of VI s and VSEA s indemnification obligations, for the costs at these facilities, and reimbursements of third party s claims for these facilities, ranged in total from $7.2 million to $36.1 million. The time frames over which these costs are estimated to be incurred vary, ranging from 1 year to 30 years as of January 1, 2010. As to each of these facilities, management determined that a particular amount within the range of estimated costs was a better estimate than any other amount within the range, and that the amount and timing of these future costs were reliably determinable. The best estimate within that range was $15.5 million at January 1, 2010. Accordingly, the Company has accrued $11.3 million for these costs, which represents the best estimate discounted at 4%, net of inflation. This accrual is in addition to the

$2.8 million described in the preceding paragraph.

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These amounts are only estimates of anticipated future costs. The amounts the Company will actually spend may be greater or less than these estimates, even as the Company believes the degree of uncertainty will narrow as cleanup activities progress. While the Company believes its reserve is adequate, as the scope of the Company s obligations becomes more clearly defined, the Company may modify the reserves, and charge or credit future earnings accordingly. Nevertheless, based on information currently known to management, and assuming VI and VSEA satisfy their indemnification obligations, management believes the costs of these environmental-related matters are not reasonably likely to have a material adverse effect on the consolidated financial statements of the Company in any one fiscal year.

The Company evaluates its liability for investigation and cleanup costs in light of the obligations and apparent financial strength of potentially responsible parties and insurance companies with respect to which the Company believes it has rights to indemnity or reimbursement. The Company has asserted claims for recovery of environmental investigation and cleanup costs already incurred, and to be incurred in the future against various insurance companies and other third parties. The Company receives certain cash payments in the form of settlements and judgments from defendants, insurers and other third parties from time to time. The Company has also reached an agreement with an insurance company under which that insurer has agreed to pay a portion of the Company s past and future environmental-related expenditures. The Company recorded receivables from that insurer of $2.8 million both at January 1, 2010 and at October 2, 2009, which were included in Other assets in the Condensed Consolidated Balance Sheets. The Company believes that this receivable is recoverable because it is based on a binding, written settlement agreement with what appears to be a financially viable insurance company, and the insurance company has paid the Company s claims in the past.

The availability of the indemnities of VI and VSEA will depend upon the future financial strength of VI and VSEA. Given the long-term nature of some of the liabilities, VI and VSEA may be unable to fund the indemnities in the future. It is also possible that a court would disregard this contractual allocation among the parties and require the Company to assume responsibility for obligations allocated to another party, particularly if the other party were to refuse or was unable to pay any of its allocated share. The agreement governing the spin-offs generally provides that if a court prohibits a company from satisfying its shared indemnification obligations, the indemnification obligations will be shared equally by the two other companies.

Acquisition-Related Commitments/Obligations

When the Company acquired ACCEL in January 2007, ACCEL was involved in a contract-related lawsuit, which the Company settled by agreeing to perform certain services for a fixed price contract (the Fixed Price Contract). As of October 2, 2009, the Company had recorded a loss accrual of 7.6 in relation to the Fixed Price Contract. In the first quarter of fiscal year 2010, the Company entered into a new contract (the New Contract) to perform certain services for a fixed price and the Company recorded a loss accrual of 0.9 million in connection with the New Contract. As of January 1, 2010, the balance of the loss accrual related to this contingency was 0.8 million. If the actual costs related to the contingency exceed the estimated amount or if the estimated loss increases, the variances will be recognized in the Consolidated Statement of Earnings in the periods these variances arise.

Other Matters

The Company is involved, from time to time, in legal proceedings, claims and government inspections or investigations both in and outside the United States, arising in the ordinary course of its business. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. The Company accrues amounts, to the extent they can be reasonably estimated, that it believes are adequate to address any liabilities related to legal proceedings and other loss contingencies that the Company believes will result in a probable loss. While there can be no assurances as to the ultimate outcome of any legal proceeding or other loss contingency involving the Company, management does not believe any pending matter will be resolved in a manner that would have a material adverse effect on the Company s consolidated financial position, results of operations or cash flows.

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10. RETIREMENT PLANS

The Company s net defined benefit and post-retirement benefit costs were composed of the following:

(In thousands)	Three Months Ended January 1, 2010	January 2, 2009
Defined Benefit Plans		
Service cost	$ 622	$ 500
Interest cost	1,263	1,221
Expected return on plan assets	(1,246)	(1,273)
Amortization of prior service cost	37	37
Recognized actuarial loss	418	269
Net periodic benefit cost	$ 1,094	$ 754
Post-Retirement Benefit Plans		
Interest cost	$ 79	$ 91
Amortization of transition amount	18	123
Amortization of prior service cost	1	1
Recognized actuarial (gain) loss	16	(8)
Net periodic benefit cost	$ 114	$ 207

The Company made contributions to the defined benefit plans of $2.0 million during the three months ended January 1, 2010. The Company currently expects total contributions to the defined benefit plans for fiscal year 2010 will be approximately $5.7 million. The Company made contributions to the post-retirement benefit plans of $0.1 million during the three months ended January 1, 2010. The Company currently expects total contributions to the post-retirement benefit plans for fiscal year 2010 will be approximately $0.5 million.

Because amounts related to retirement plans of Research Instruments, which is classified as a discontinued operation, were not material for any period presented, the Company has not segregated them from continuing operations in this note. See Note 16, Discontinued Operations.

11. INCOME TAXES

The Company s effective tax rate was 33.7% for the three months ended January 1, 2010, compared to 30.5% for the same period of fiscal year 2009. The increase in the Company s effective tax rate for the three-month period ended January 1, 2010 was primarily a result of the inclusion in the year-ago period of a greater net benefit for discrete items, primarily related to the release of certain liabilities for uncertain tax positions as a result of the lapse of the statutes of limitation in various jurisdictions, and the benefit of the retroactive reinstatement of the federal research and development credit.

The Company s effective income tax rate differs from the U.S. federal statutory rate primarily because the Company s foreign earnings are taxed at rates that are, on average, lower than the U.S. federal rate, and because the Company s domestic earnings are subject to state income taxes.

The total amount of unrecognized tax benefits did not change by a significant amount during the three months ended January 1, 2010; however, the amount of unrecognized tax benefits has increased as a result of positions taken during the current and prior years, and has decreased as a result of lapses of the statutes of limitation and audit settlements in various jurisdictions. It is reasonably possible that the Company s unrecognized tax benefits will decrease within the next 12 months. Unrecognized tax benefits of approximately $14.0 million related to the tax treatment of certain timing differences may be reduced if the Internal Revenue Service consents to a tax accounting method change that the Company has requested.

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12. STOCKHOLDERS EQUITY

Stock Repurchase Program

On November 17, 2008, VMS s Board of Directors authorized the repurchase of 8,000,000 shares of VMS common stock from January 1, 2009 through December 31, 2009. During the three months ended January 1, 2010, the Company paid $55.2 million to repurchase 1,250,000 shares of VMS common stock. All shares that have been repurchased have been retired. The November 17, 2008 authorization expired on December 31, 2009 with 6,050,000 shares available for repurchase. On November 13, 2009, the Company s Board of Directors authorized the repurchase of an additional 5,000,000 shares of VMS common stock from January 1, 2010 through December 31, 2010.

Comprehensive Earnings

The components of comprehensive earnings are as follows:

	Three Months Ended	
(In thousands)	January 1, 2010	January 2, 2009
Net earnings	**$ 78,775**	**$ 68,797**
Other comprehensive income, net of tax:		
Defined benefit pension and post-retirement benefit plans:		
Amortization of transition obligation included in net periodic benefit cost	11	76
Amortization of prior service cost included in net periodic benefit cost	33	33
Amortization of net actuarial loss included in net periodic benefit cost	331	189
	375	298
Unrealized gain on derivatives:		
Increase (decrease) in unrealized gain	716	2,293
Reclassification adjustments	(14)	(721)
	702	1,572
Currency translation adjustment	(1,666)	(1,882)
Other comprehensive income (loss)	**(589)**	**(12)**
Total comprehensive earnings	**$ 78,186**	**$ 68,785**

Because amounts related to Research Instruments, which is classified as a discontinued operation, were not material for any period presented, the Company has not segregated them from continuing operations in this note. See Note 16 Discontinued Operations for a detailed discussion.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

13. EMPLOYEE STOCK PLANS

The table below summarizes the share-based compensation expense under ASC 718:

	Three Months Ended	
(In thousands, except per share amounts)	**January 1, 2010**	**January 2, 2009**
Cost of revenues - Product	$ 891	$ 1,076
Cost of revenues - Service contracts and other	659	1,041
Research and development	1,071	1,249
Selling, general and administrative	6,224	7,340
Taxes on earnings	(3,133)	(3,464)
Net decrease in net earnings	$ 5,712	$ 7,242
Increase (decrease) on:		
Cash flows from operating activities (1)	$ (1,430)	$ (2,996)
Cash flows from financing activities (1)	$ 1,430	$ 2,996

(1) Amounts represent excess tax benefits from share-based compensation.

During the three months ended January 1, 2010, total share-based compensation expense recognized in earnings before taxes was $8.8 million and the total related recognized tax benefit was $3.1 million. During the three months ended January 2, 2009, total share-based compensation expense recognized in earnings before taxes was $10.7 million and the total related recognized tax benefit was $3.5 million. Total share-based compensation expense capitalized as part of inventory for the three months ended January 1, 2010 was $0.2 million. Total share-based compensation expense capitalized as part of inventory for the three months ended January 2, 2009 was $0.5 million.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

No options were granted in the three months ended January 2, 2009. The fair value of options granted in the three months ended January 1, 2010 was estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions:

	Three Months Ended January 1, 2010
Employee Stock Option Plans	
Expected term (in years)	4.42
Risk-free interest rate	2.0%
Expected volatility	37.6%
Expected dividend	
Weighted average fair value at grant date	$ 15.27

In May 2009, as part of a broader set of cost control initiatives, VMS s Board of Directors authorized the suspension of the Employee Stock Purchase Plan beginning in October 2009. The option component of the Employee Stock Purchase Plan shares for the three months ended January 2, 2009 was estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions:

	Three Months Ended January 2, 2009
Employee Stock Purchase Plan	
Expected term (in years)	0.50
Risk-free interest rate	0.5%
Expected volatility	45.8%
Expected dividend	
Weighted average fair value at grant date	$ 15.86

Activity under the Company s employee stock plans is presented below:

		Options Outstanding			
(In thousands, except per share amounts)	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (2)
Balance at October 2, 2009	5,352	11,853	$ 40.59		
Granted	(10)	10	45.22		
Cancelled or expired [1]	129	(84)	49.75		
Exercised		(343)	25.59		
Balance at January 1, 2010	5,471	11,436	$ 40.97	4.9	$ 89,075
Exercisable at January 1, 2010		9,939	$ 40.86	4.7	$ 78,962

(1) The difference between the number of shares subject to options outstanding and the number of shares available for grant under the Company s employee stock plans represents (a) the cancellation of shares of restricted common stock due to employee terminations and (b) the cancellation of shares of restricted common stock that were tendered to VMS to satisfy employee tax withholding obligations for vested restricted common stock.

(2) The aggregate intrinsic value represents the total pre-tax intrinsic value, which is computed based on the difference between the exercise price and VMS s closing common stock price of $46.85 as of December 31, 2009, that last trading date of the first quarter of fiscal year 2010, and which would have been received by the option holders had all option holders exercised and sold their options as of that date.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

As of January 1, 2010, there was $10.4 million of total unrecognized compensation expense related to outstanding stock options. This unrecognized compensation expense is expected to be recognized over a weighted average period of 1.6 years.

The activity for restricted stock and deferred stock units is summarized as follows:

(In thousands, except per share amounts)	Shares	Weighted Average Grant-Date Fair Value
Balance at October 2, 2009	1,172	$ 42.89
Granted		
Vested	(21)	50.27
Cancelled or expired	(10)	43.62
Balance at January 1, 2010	1,141	$ 42.75

As of January 1, 2010, unrecognized compensation expense totaling $32.0 million was related to restricted stock and deferred stock units. This unrecognized compensation expense is expected to be recognized over a weighted average period of 2.2 years.

Because amounts related to employee stock plans of Research Instruments, which is classified as a discontinued operation, were not material for any period presented, the Company has not segregated them from continuing operations in this note. See Note 16, Discontinued Operations.

14. EARNINGS PER SHARE

Basic net earnings per share is computed by dividing net earnings by the weighted average number of shares of common stock outstanding for the period. Diluted net earnings per share is computed by dividing net earnings by the sum of the weighted average number of common shares outstanding and dilutive common shares under the treasury method.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

The following table sets forth the computation of net basic and diluted earnings per share:

	Three Months Ended	
(In thousands, except per share amounts)	**January 1, 2010**	**January 2, 2009**
Earnings from continuing operations	$ 78,775	$ 69,579
Loss from discontinued operations, net of taxes		(782)
Net earnings	$ 78,775	$ 68,797
Basic weighted average shares outstanding	123,690	123,818
Dilutive effect of potential common shares	1,371	1,349
Diluted weighted average shares outstanding	125,061	125,167
Net earnings per share - basic:		
Continuing operations	$ 0.64	$ 0.56
Discontinued operations		
Net earnings per share	$ 0.64	$ 0.56
Net earnings (loss) per share - diluted:		
Continuing operations	$ 0.63	$ 0.56
Discontinued operations		(0.01)
Net earnings per share	$ 0.63	$ 0.55

The Company excludes shares underlying stock options from the computation of diluted weighted average shares outstanding if the per share value, including the sum of (a) the exercise price of the options and (b) the amount of the compensation cost attributed to future services and not yet recognized, is greater than the average market price of the shares, because the inclusion of the shares underlying these stock options would be antidilutive to earnings per share. Accordingly, stock options to purchase 5,992,106 shares at an average exercise price of $49.49 per share were excluded from the computation of diluted weighted average shares outstanding for the three months ended January 1, 2010. For the three months ended January 2, 2009, stock options to purchase 5,646,302 shares at an average exercise price of $50.70 per share were excluded from the computation of diluted weighted average shares outstanding.

15. SEGMENT INFORMATION

The Company s operations are grouped into two reportable operating segments: Oncology Systems and X-ray Products. These reportable operating segments were determined based on how the Company s Chief Executive Officer, its Chief Operating Decision Maker (CODM), views and evaluates the Company s operations. The Company s Ginzton Technology Center (GTC), SIP business and Varian Particle Therapy (previously known as ACCEL Proton Therapy) are reflected in the Other category because these operations do not meet the criteria of a reportable operating segment. The CODM allocates resources to and evaluates the financial performance of each operating segment primarily based on operating earnings.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

The following table summarizes selected operating results information for each business segment:

	Three Months Ended	
(In millions)	**January 1, 2010**	**January 2, 2009**
Revenues		
Oncology Systems	$ 430	$ 398
X-ray Products	91	86
Total reportable segments	$ 521	$ 484
Other	20	25
Total company	$ 541	$ 509
Operating Earnings (Loss)		
Oncology Systems	$ 102	$ 98
X-ray Products	23	21
Total reportable segments	$ 125	$ 119
Other	(11)	
Corporate [(1)]	5	(20)
Total company	$ 119	$ 99

(1) Corporate includes shared costs of legal, tax, accounting, human resources, real estate, insurance, information technology, treasury, finance and other management costs. Prior to fiscal year 2010, only a portion of the indirect and common costs has been allocated through the use of estimates. Beginning in fiscal year 2010, budgeted indirect and common costs included in Corporate are fully allocated through the use of estimates. If the fiscal year 2010 corporate expense allocation method was applied in the first quarter of fiscal year 2009, operating earnings (loss) would have been $82 million for Oncology Systems, $18 million for X-ray Products, $(2) million for the Other category and $1 million for Corporate.

16. DISCONTINUED OPERATIONS

In September 2008, the Company approved a plan to sell Research Instruments, which developed, manufactured and serviced highly customized scientific instrument components and systems for fundamental and applied physics research primarily for national research laboratories worldwide. Research Instruments was part of the January 2007 ACCEL acquisition and was previously included in the Other category in the Company s Condensed Consolidated Financial Statements. The Company decided to sell Research Instruments in order to focus exclusively on the development of its Varian Particle Therapy business. In the second quarter of fiscal year 2009, the Company completed the sale of Research Instruments for total cash proceeds of $0.4 million. In connection with the sale of Research Instruments, the Company entered into a non-binding supply agreement with the buyer to supply certain inventory parts for the Varian Particle Therapy business. The supply agreement can be terminated by either party upon a six months notice after December 31, 2011. The inventory purchases under this supply agreement are not expected to have a significant impact on the cash flows of Research Instruments.

The Company classified the operating results of Research Instruments as a discontinued operation in the Condensed Consolidated Statements of Earnings for all periods presented. Because the amounts related to Research Instruments are not material in the Condensed Consolidated Balance Sheet and the Condensed Consolidated Statements of Cash Flows for all periods presented, the Company has not segregated them from continuing operations.

Total revenues of Research Instruments, reported in discontinued operations, for the three months ended January 1, 2010, and January 2, 2009 were $0.1 million and $4.2 million, respectively. Research Instruments did not have any profit or loss for the three months ended January 1, 2010 and loss reported in discontinued operations was $0.8 million for the three months ended January 2, 2009.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and

Stockholders of Varian Medical Systems, Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Varian Medical Systems, Inc. and its subsidiaries (the Company) as of January 1, 2010 and the related condensed consolidated statements of earnings for the three-month period ended January 1, 2010 and January 2, 2009 and the condensed consolidated statements of cash flows for the three-month period ended January 1, 2010 and January 2, 2009. These interim financial statements are the responsibility of the Company s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of October 2, 2009, and the related consolidated statements of earnings, of stockholders equity and of cash flows for the year then ended (not presented herein), and in our report dated November 25, 2009, we expressed unqualified opinions on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of October 2, 2009, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP

San Jose, CA
February 9, 2010

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

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 which provides a safe harbor for statements about future events, products and future financial performance that are based on the beliefs of, estimates made by and information currently available to the management of Varian Medical Systems, Inc. (VMS) and its subsidiaries (collectively we, our or the Company). The outcome of the events described in these forward-looking statements is subject to risks and uncertainties. Actual results and the outcome or timing of certain events may differ significantly from those projected in these forward-looking statements or management s current expectations due to the factors cited in this Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A), the Risk Factors listed under Part II, Item 1A of this Quarterly Report on Form 10-Q, and other factors described from time to time in our other filings with the Securities and Exchange Commission (SEC), or other reasons. For this purpose, statements concerning: industry or market segment outlook; market acceptance of or transition to new products or technology such as fixed field intensity-modulated radiation therapy (IMRT), image-guided radiation therapy (IGRT), volumetric modulated arc therapy (VMAT), stereotactic radiotherapy, stereotactic radiosurgery, brachytherapy, software, treatment techniques, proton therapy and advanced x-ray products; growth drivers; future orders, revenues, backlog, earnings or other financial results; and any statements using the terms believe, expect, expectation, anticipate, can, should, will, would, could, estimate, continue, grow, based on, may, intended, potential, ongoing, statements are forward-looking statements. By making forward-looking statements, we have not assumed any obligation to, and you should not expect us to, update or revise those statements because of new information, future events or otherwise.

Overview

Net earnings from continuing operations per diluted share increased 13% to $0.63 in the first quarter of fiscal year 2010 from $0.56 in the first quarter of fiscal year 2009. In the first quarter of fiscal year 2010, revenues from continuing operations grew 6% from the year-ago quarter. Cost control initiatives, favorable product mix and favorable currency impact contributed to an improvement in gross margin and the growth in net earnings in the first quarter of fiscal year 2010 over the year ago quarter. In the first quarter of fiscal year 2010, we reversed a $62 million order from Skandion Kliniken for a proton therapy system, which contributed to a 10% decline in net orders from the year-ago quarter. Compared to the year-ago quarter, Oncology Systems and X-ray Products net orders increased in the first quarter of fiscal year 2010, primarily driven by growth in the international region, mostly offset by declines in North America, where these business segments continued to experience the effect of the recession and the uncertainty created by the prospects of the healthcare reform in the United States. At the end of the first quarter of fiscal year 2010, our backlog grew 4% from the end of the year-ago quarter. We ended the first quarter of fiscal year 2010 with $625 million of cash and cash equivalents.

Effective in the fourth quarter of fiscal year 2008, we classified the scientific research instruments business (Research Instruments) of ACCEL Instruments GmbH (ACCEL) (which subsequently changed its name to Varian Medical Systems Particle Therapy GmbH) as a discontinued operation. Research Instruments is classified as a discontinued operation for all periods presented in our Condensed Consolidated Statements of Earnings. Unless otherwise stated, the discussion in this MD&A pertains to our continuing operations.

Oncology Systems. Our largest business segment is Oncology Systems, which designs, manufacturers, sells and services hardware and software products for radiation treatment of cancer with conventional radiotherapy, IMRT, IGRT, VMAT (a special form of IMRT), stereotactic radiotherapy, stereotactic radiosurgery and brachytherapy.

In our view, the fundamental market forces that should drive long-term growth in radiation therapy, stereotactic radiosurgery and brachytherapy are the rising cancer incidence; technology advances and product developments that are leading to improvements in patient care; customer demand for more advanced and effective cancer treatments, such as fixed field IMRT, IGRT, stereotactic radiosurgery, brachytherapy and VMAT; competitive conditions among hospitals and clinics to offer such advanced treatments; continued improvement in safety and cost efficiency in delivering radiation therapy; and underserved medical needs outside of the United States. Our primary goal in the Oncology Systems business is to promote the adoption of more advanced and effective cancer treatments.

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In the first quarter of fiscal year 2010, Oncology Systems net revenues increased over the year-ago quarter. The increase in revenues was primarily driven by increases in revenues from service contracts and from increased sales of our software products, including our RapidArc™ products, which had more than 340 installations as of the end of the first quarter of fiscal year 2010. International revenues increased over the year-ago quarter, but were significantly offset by a decline in North America. During the first quarter of fiscal year 2010, Oncology Systems gross margin improved by 2.8 percentage points, largely due to a significant improvement in service contract gross margin and, to a lesser extent, an improvement in product gross margin.

In the first quarter of fiscal year 2010, total Oncology Systems net orders increased slightly compared to the first quarter of fiscal year 2009, although on a constant currency basis, total net orders decreased slightly. Compared to the year-ago quarter, net orders for our Trilogy linear accelerators and Novalis Tx products for the hybrid market segment of radiosurgery in radiotherapy centers made up a higher proportion of net orders for our high energy accelerators in the first quarter of fiscal year 2010. International net orders increased compared to the year-ago period, with double digit net orders growth in Europe and Asia. North America declined compared to the year-ago period, with orders from both free standing clinics and hospitals declining. We have seen early signs of renewed interest from free-standing clinics following the October 2009 announcement by the U.S. Centers for Medicare and Medicaid Services of more modest 2010 Medicare reimbursement rate reductions than originally proposed for radiotherapy and radiosurgery at free-standing clinics, though the confusion and uncertainty created by the original proposed reductions continued into the quarter. Hospitals in North America continued to experience the effects of smaller capital budgets established in 2009 by many health care providers in response to the recession, and continued to be negatively impacted by the uncertainty created by the prospects of healthcare reform in the United States. We expect that uncertainty in North American radiation therapy capital spending will persist so long as the economic downturn continues and until there is greater clarity on healthcare reform.

Our success in Oncology Systems largely depends upon our ability to retain leadership in technological innovation, the reliability and cost effectiveness of our products, the efficacy of our treatment technology and external influences. External influences that could affect our results of operations include the current state of healthcare reform, significant changes to Medicare and Medicaid reimbursement rates for radiotherapy, radiosurgery and brachytherapy procedures in the United States, the financial strength of our customers, and government budgeting and tendering cycles. The current worldwide economic downturn has caused hospitals, clinics and research institutions to more closely scrutinize and prioritize their capital spending and lengthen their decision making processes regarding purchases of our products. Historically, our business has felt the effects of market trends later than other sectors in the healthcare industry, such as diagnostic radiology, and it is possible that we may experience the effects of any economic recovery later than others in the healthcare industry.

Overall, the U.S. dollar was weaker against foreign currencies in the first quarter of fiscal year 2010 than it was in the first quarter of fiscal year 2009, which made our pricing more competitive in the local currencies of our international customers and favorably impacted our net order and revenue growth in the international region when measured in U.S. dollars. The fluctuation of the U.S dollar against foreign currencies also impacts our international revenues and net orders when measured in U.S. dollars. Each of these factors, and others that may affect our Oncology Systems business, are more fully described under Risk Factors in Item 1A.

X-ray Products. Our X-ray Products business segment designs, manufactures and sells: (i) x-ray tubes for use in a range of applications, including computed tomography (CT) scanning, radiographic or fluoroscopic imaging, mammography, special procedures and industrial applications; and (ii) flat panel digital image detectors for filmless x-ray imaging, which is for radiography an alternative to image intensifier tubes for fluoroscopy and x-ray film and computed radiography (CR) systems. We continue to view the long-term fundamental growth driver for this business to be the ongoing success of key x-ray imaging original equipment manufacturers (OEMs) that incorporate our x-ray tube products and flat panel detectors into their medical diagnostic, dental, veterinary and industrial imaging systems.

Compared to the first quarter of fiscal year 2009, X-ray Products net orders and revenues in the first quarter of fiscal year 2010 grew internationally but declined in North America, as this region continued to be impacted by the slowdown in the market for imaging equipment. During the first quarter of fiscal year 2010, our radiographic flat panels were a key contributor to net orders and revenue growth while x-ray tube net orders and revenues decreased versus the first quarter of fiscal year 2009. In the first quarter of fiscal year 2010, net orders for our flat panel products surpassed net orders for our x-ray tubes for the first time.

Our success in our X-ray Products business depends upon our ability to anticipate changes in our markets, the direction of technological innovation and the demands of our customers. The general worldwide economic downturn has negatively impacted the businesses of our OEM customers, causing them to adjust inventory levels and reduce their purchasing patterns. The market for new X-ray imaging equipment has been weak, and certain product lines, such as dental and veterinary, have

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been hit particularly hard in the recession. In recent years, we have also seen dramatic reductions in Medicare reimbursements for diagnostic radiology, which we believe have reduced demand for medical x-ray imaging equipment, such as CT scanners, and therefore which have negatively impacted demand for our x-ray tube products in the United States. Each of these factors, and others that may affect our X-ray Products business, are more fully described under Risk Factors in Item 1A.

Other. The Other category is comprised of Security and Inspections Products (SIP), the Varian Particle Therapy business, and the operations of the Ginzton Technology Center (GTC). (Please refer to Note 15, Segment Information to the Condensed Consolidated Financial Statements within this Quarterly Report on Form 10-Q.)

SIP designs, manufactures, sells and services Linatron® x-ray accelerators, imaging processing software and image detection products (including IntellX) for security and inspection purposes, such as cargo screening at ports and borders and nondestructive examination in a variety of applications. Generally, we sell our SIP products to OEMs who incorporate them into their inspection systems.

Use of this technology in security cargo screening and border protection is still in its early stages but we believe growth in the SIP business will be driven by cargo screening and border protection needs, as well as by the needs of customs agencies to verify the contents of shipments for assessing duties and taxes. As a result, this business is heavily influenced by U.S. and foreign governmental policies on national and homeland security, political change, and government budgets and appropriations. Orders and revenues for our SIP products have been and may continue to be unpredictable as governmental agencies may place large orders with us or our OEM customers in a short time period, and then may not place any orders for a long time period thereafter. In addition, the current recession has caused some of our SIP customers to postpone their purchasing decisions. Each of these factors, and others that may affect our SIP business, are more fully described under Risk Factors in Item 1A.

Our Varian Particle Therapy business designs, develops, manufactures and services products and systems for delivering proton therapy, another form of external beam radiotherapy using proton beams for the treatment of cancer. Proton therapy is considered as a preferred option for treating certain kinds of cancers, particularly tumors near critical structures such as the optic nerve and cancers in children. Although proton therapy has been in clinical use for more than four decades, it has not been widely deployed due to the cost of the technology and limited cost effectiveness. We are investing substantial resources to commercialize this advanced proton technology and to build this new business. In the second quarter of fiscal year 2009, we met the Conformité Européenne (CE) mark requirements that permit us to market our proton therapy systems within the European Economic Area (EEA) and patient treatments started on our proton therapy system that is installed at a customer facility in Munich, Germany. In the first quarter of fiscal year 2010, we commissioned a second treatment gantry at the facility.

Proton therapy facilities are large scale construction projects that are time consuming and involve significant customer investment and perhaps complex project financing. Consequently, this business is vulnerable to the general worldwide economic downturn and contraction in the credit markets. In addition, the customers decision-making cycle is very long and orders for proton therapy systems generally involve many contingencies. Under our current practice, we will only recognize proton therapy system orders with contingencies if we deem the contingencies perfunctory or if we publicly disclose the existence and nature of material contingencies.

GTC, our scientific research facility, continues to invest in developing technologies that enhance our current businesses or may lead to new business areas, including next generation digital x-ray imaging technology, volumetric and functional imaging, and improved x-ray sources and technology for security and cargo screening applications. In addition, GTC is developing technologies and products that are designed to improve disease management by more precise targeting of radiation, as well as by employing targeted energy and molecular agents to enhance the effectiveness and broaden the application of radiation therapy.

In the first quarter of fiscal year 2010, net orders in the Other category declined $73 million to a negative $40 million, primarily due to the cancellation of a $62 million proton therapy system order from Skandion Kliniken, which is discussed in more detail in this MD&A under Net Orders. Compared to very strong revenues and net orders in the year-ago quarter, SIP revenues and net orders decreased in the first quarter of fiscal year 2010.

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This discussion and analysis of our financial condition and results of operations is based upon and should be read in conjunction with the Condensed Consolidated Financial Statements and the notes included elsewhere in this Quarterly Report on Form 10-Q, as well as the Consolidated Financial Statements and the Notes to the Consolidated Financial Statements and the related Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended October 2, 2009 (the 2009 Annual Report), as well as the Risk Factors contained in Part II, Item 1A of this Quarterly Report on Form 10-Q, and other information provided from time to time in our other filings with the SEC.

Critical Accounting Estimates

The preparation of our financial statements and related disclosures in conformity with accounting principles generally accepted in the United States (GAAP) requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and assumptions are based on historical experience and on various other factors that we believe are reasonable under the circumstances. We periodically review our accounting policies, estimates and assumptions and make adjustments when facts and circumstances dictate. In addition to the accounting policies that are more fully described in the Notes to the Consolidated Financial Statements included in our 2009 Annual Report, we consider the critical accounting policies described below to be affected by critical accounting estimates. Our critical accounting policies that are affected by accounting estimates include share-based compensation expense, revenue recognition, valuation of allowance for doubtful accounts, valuation of inventories, assessment of recoverability of goodwill and intangible assets, valuation of warranty obligations, assessment of environmental remediation liabilities, valuation of defined benefit pension and post-retirement benefit plans, valuation of derivative instruments and taxes on earnings. Such accounting policies require us to use judgments, often as a result of the need to make estimates and assumptions regarding matters that are inherently uncertain; and actual results could differ materially from these estimates. For a discussion of how these estimates and other factors may affect our business, also refer to the Risk Factors listed under Part II, Item 1A of this Quarterly Report on Form 10-Q.

Revenue Recognition

We frequently enter into sales arrangements with customers that contain multiple elements or deliverables such as hardware, software and services. Judgments as to the allocation of the proceeds received from an arrangement to the multiple elements of the arrangement, the determination of whether any undelivered elements are essential to the functionality of the delivered elements and the appropriate timing of revenue recognition are critical with respect to these arrangements to ensure compliance with GAAP. In addition, the amount of product revenues we recognize is affected by our judgments as to whether objective and reliable evidence of fair value exists for hardware products and vendor-specific objective evidence of the fair value for software products in arrangements with multiple elements. Changes to the elements in an arrangement and the ability to establish objective and reliable evidence of fair value or vendor-specific objective evidence of the fair value for those elements could affect the timing of revenue recognition. Revenue recognition also depends on the timing of shipment and is subject to customer acceptance and the readiness of customers facilities. If shipments are not made on scheduled timelines or if the products are not accepted by the customer in a timely manner, our reported revenues may differ materially from expectations. In addition, revenues related to our highly customized image detection systems are recognized under the percentage-of-completion method. Under the percentage-of-completion method of accounting, sales and gross profit are recognized as work is performed, based on the relationship between actual costs incurred and total estimated costs at the completion of the contract. Because the percentage-of-completion method involves considerable use of estimates in determining revenues, costs and profits and in assigning the dollar amounts to relevant accounting periods, and because the estimates must be periodically reviewed and appropriately adjusted, if our estimates prove to be inaccurate or circumstances change over time, we may be forced to adjust revenues or even record a contract loss in later periods. If a loss is expected on a contract under the percentage-of-completion method or completed contract method, the estimated loss would be charged to cost of sales in the period the loss is identified.

Share-based Compensation Expense

We value our share-based payment awards granted using the Black-Scholes option-pricing model. The determination of fair value of share-based payment awards on the date of grant using the Black-Scholes option-pricing model is affected by VMS s stock price, as well as the input of other subjective assumptions, including the expected term of stock awards and the expected price volatility of VMS stock over the expected term of the awards.

The expected term is based on the observed and expected time to post-vesting exercise and post-vesting cancellations of stock options by our employees. We determined the expected term of stock options based on the demographic grouping of employees and retirement eligibility. We used a combination of historical and implied volatility, or blended volatility, in

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deriving the expected volatility assumption. Blended volatility represents the weighted average of implied volatility and historical volatility. Implied volatility was derived based on six-month traded options on VMS common stock. Implied volatility is weighted in the calculation of blended volatility based on the ratio of the six-month term of the exchange-traded options to the expected lives of the employee stock options. Historical volatility represents the remainder of the weighting. Our decision to incorporate implied volatility was based on our assessment that implied volatility of publicly traded options on VMS common stock is reflective of market conditions and is generally reflective of both historical volatility and expectations of how future volatility will differ from historical volatility. In determining the extent of use of implied volatility, we considered: (i) the volume of market activity of traded options; (ii) the ability to reasonably match the input variables of traded options to those of stock options granted by us, including the date of grant; (iii) the similarity of the exercise prices; and (iv) the length of term of traded options. After considering the above factors, we determined that we could rely exclusively on implied volatility based on the fact that the term of VMS six-month exchange-traded options is less than one year and that it is different from the expected lives of the stock options we grant. Therefore, we believe a combination of the historical volatility over the expected lives of the stock options we granted and the implied volatility of six-month exchange-traded options best reflects the expected volatility of VMS common stock. The risk-free interest rate assumption is based upon observed interest rates appropriate for the term of our stock options. The dividend yield assumption is based on our history and expectation of no dividend payouts. If factors change and we employ different assumptions in future periods, the compensation expense that we record may differ significantly from what we have recorded in the current period. In addition, we are required to estimate the expected forfeiture rate and recognize expense only for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the stock-based compensation expense could be significantly different from what we have recorded in the current period.

Allowance for Doubtful Accounts

We evaluate the creditworthiness of our customers prior to authorizing shipment for all major sale transactions. Our payment terms usually require payment of a small portion of the total amount due when the customer signs the purchase order, a significant amount upon transfer of risk of loss to the customer and the remaining amount upon completion of the installation. On a quarterly basis, we evaluate aged items in the accounts receivable aging report and provide an allowance in an amount we deem adequate for doubtful accounts. If our evaluation of our customers financial conditions does not reflect our future ability to collect outstanding receivables, additional provisions may be needed and our operating results could be negatively affected.

Inventories

Our inventories include high technology parts and components that are highly specialized in nature and that are subject to rapid technological obsolescence. We have programs to minimize the required inventories on hand and we regularly review inventory quantities on hand and adjust for excess and obsolete inventory based primarily on historical usage rates and our estimates of product demand and production. Actual demand may differ from our estimates, in which case we may have understated or overstated the provision required for obsolete and excess inventory, which would have an impact on our operating results.

Goodwill and Intangible Assets

Goodwill is initially recorded when the purchase price paid for a business acquisition exceeds the estimated fair value of the net identified tangible and intangible assets acquired. The majority of businesses that we have acquired have not had significant identified tangible assets and, as a result, we have typically allocated a significant portion of the purchase price to intangible assets and goodwill. Our future operating performance will be impacted by the future amortization of these acquired intangible assets and potential impairment charges related to these intangibles or to goodwill if indicators of impairment exist. The allocation of the purchase price from business acquisitions to goodwill and intangible assets could have a significant impact on our future operating results. In addition, the allocation of the purchase price of the acquired businesses to goodwill and intangible assets requires us to make significant estimates and assumptions, including estimates of future cash flows expected to be generated by the acquired assets and the appropriate discount rate for these cash flows. Should conditions differ from management s estimates at the time of the acquisition, material write-downs of intangible assets and/or goodwill may be required, which would adversely affect our operating results.

In accordance with Accounting Standard Codification (ASC 350), we evaluate goodwill for impairment at least annually or whenever an event occurs or circumstances changes that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The impairment test for goodwill is a two-step process. Step one consists of a comparison of the fair value of a reporting unit against its carrying amount, including the goodwill allocated to each reporting unit. We

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determine the fair value of our reporting units based on the present value of estimated future cash flows of the reporting units. If the carrying amount of the reporting unit is in excess of its fair value, step two requires the comparison of the implied fair value of the reporting unit s goodwill against the carrying amount of the reporting unit s goodwill. Any excess of the carrying value of the reporting unit s goodwill over the implied fair value of the reporting unit s goodwill is recorded as an impairment loss. The impairment test for intangible assets with indefinite useful lives, if any, consists of a comparison of fair value to carrying value, with any excess of carrying value over fair value being recorded as an impairment loss. Based on the most recent annual goodwill impairment testing that we performed in the fourth quarter of fiscal year 2009 for each of our four reporting units with goodwill (Oncology Systems, X-ray Products, SIP and Varian Particle Therapy), the fair value of each such reporting unit was substantially in excess of its carrying value. We will continue to make assessments of impairment on an annual basis in the fourth quarter of our fiscal years or more frequently if indicators of potential impairment arise.

Warranty Obligations

We warrant most of our products for a specific period of time, usually twelve months, against material defects. We provide for the estimated future costs of warranty obligations in cost of revenues when the related revenues are recognized. The accrued warranty costs represent our best estimate at the time of sale of the total costs that we will incur to repair or replace product parts that fail while still under warranty. The amount of accrued estimated warranty costs obligation for established products is primarily based on historical experience as to product failures adjusted for current information on repair costs. For new products, estimates will include historical experience of similar products, as well as reasonable allowance for start-up expenses. Actual warranty costs could differ from the estimated amounts. On a quarterly basis, we review the accrued balances of our warranty obligations and update the historical warranty cost trends, if required. If we were required to accrue additional warranty costs in the future, it would have a negative effect on our operating results.

Environmental Matters

We are subject to a variety of environmental laws around the world. Those laws regulate multiple aspects of our operations, including the handling, storage, transport and disposal of hazardous substances. They impose costs on our operations and in connection with past operations. In connection with past operations, we record environmental remediation liabilities when we conclude that environmental assessments or remediation efforts are probable and we believe we can reasonably estimate the costs of those efforts. Our accrued environmental costs represent our best estimate of the total costs of assessments and remediation and the time period over which we expect to incur those costs. We review these accrued balances quarterly. Were we required to increase or decrease the accrued environmental costs in the future, it would adversely or favorably impact our operating results.

Defined Benefit Pension and Post-Retirement Benefit Plans

We sponsor five defined benefit pension plans in Germany, Japan, Switzerland and the United Kingdom covering employees who meet the applicable eligibility requirements in these countries. In July 2007, we made changes to the defined benefit pension plan in the United Kingdom by terminating the accrual of additional benefits for existing participants and suspending the enrollment of new participants. We also sponsor a post-retirement benefit plan that provides healthcare benefits to certain eligible retirees in the United States. We do not have any defined benefit pension plans in the United States. Several statistical and other factors that attempt to anticipate future events are used in calculating the expense and liability related to those plans for which the benefit is actuarially determined, such as our defined benefit pension and post-retirement benefit plans. These factors include assumptions about the discount rate, expected return on plan assets, rate of future compensation increases and rate of healthcare cost increases, all of which we determine within certain guidelines. In addition, we also use assumptions, such as withdrawal and mortality rates, to calculate the expense and liability. The actuarial assumptions we use are long-term assumptions and may differ materially from actual experience particularly in the short term due to changing market and economic conditions and changing participant demographics. These differences may have a significant impact on the amount of defined benefit pension and post-retirement benefit plan expense we record.

The expected rates of return on the various defined benefit pension plans assets are based on the asset allocation of each plan and the long-term projected return on those assets. The discount rate enables us to state expected future cash flows at a present value on the measurement date. The discount rates used for defined benefit plans in all countries are based primarily on the yields of a universe of high quality corporate bonds in each country or the spot rate of high quality AA-rated corporate bonds, with durations corresponding to the expected durations of the benefit obligations. In countries where the corporate bond market is not sufficiently representative of the time period at longer durations, the discount rate also takes into account the yield of long-term government bonds corresponding to the duration of the benefit obligations and the difference between the yield curve on high quality corporate fixed-income investments and government fixed-income investment. A change in the discount rate will cause the present value of benefit obligations to change in the opposite direction.

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Valuation of Derivative Instruments

We use foreign currency forward contracts to reduce the effects of currency fluctuations on sales transactions denominated in foreign currencies and on assets and liabilities denominated in foreign currencies. These foreign currency forward contracts are derivative instruments and are measured at fair value. ASC 820 establishes three levels of inputs that may be used to measure fair value (see Note 3, Fair Value Measurements to Condensed Consolidated Financial Statements). Each level of input has different levels of subjectivity and difficulty involved in determining fair value. The fair value of foreign currency forward contracts are calculated primarily using Level 2 inputs, which include currency spot and forward rates, interest rate and credit or non-performance risk. The spot rate for each currency is the same spot rate used for all balance sheet translations at the measurement date and sourced from our major trading banks. The following values are interpolated from commonly quoted broker services: forward point values for each currency and the London Interbank Offered Rate (LIBOR) to discount assets and liabilities. One year credit default swap spreads of the counterparty at the measurement date are used to adjust derivative assets, all of which have maturity terms of less than 12 months, for non-performance risk. We are required to adjust derivative liabilities to reflect the potential non-performance risk to lenders based on our incremental borrowing rate. Each contract is individually adjusted using the counterparty (for net asset) or our discount rate (for net liability). The use of Level 2 inputs in determining fair values requires certain management judgment and subjectivity. Changes to these Level 2 inputs could have a material impact to the valuation of our derivative instruments, as well as on our result of operations.

Taxes on Earnings

We are subject to taxes on earnings in both the United States and numerous foreign jurisdictions. As a global taxpayer, significant judgments and estimates are required in evaluating our tax positions and determining our provision for taxes on earnings.

The provisions in ASC 740 related to accounting for uncertainty in income taxes contains a two-step approach to recognizing, derecognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining whether the weight of available evidence indicates that it is more likely than not that, based on the technical merits, the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement. Recognition, derecognition and measurement are based on management s best judgment given the facts, circumstances and information available at the end of the accounting period. A tax benefit should be recognized in the first period in which it meets the more likely than not recognition threshold, and conversely, a tax benefit previously recognized should be derecognized in the first period in which new information results in a change in judgment in which the position fails to meet the recognition threshold. A benefit not previously recognized would be recognized when the tax position is effectively settled through examination, negotiation or litigation with tax authorities, or when the statute of limitations for the relevant taxing authority to examine and challenge the position has expired. Our policy is to include interest and penalties related to unrecognized tax benefits within the provision for taxes on earnings.

In addition, the carrying value of our net deferred tax assets assumes that we will be able to generate sufficient future taxable earnings in certain tax jurisdictions to utilize these deferred tax assets. Should we conclude it is more likely than not that we will be unable to recover our net deferred tax assets in these tax jurisdictions, we would increase our valuation allowance and our tax provision would increase in the period in which we make such a determination.

Earnings derived from our international regions are generally taxed at rates lower than U.S. rates. Our effective tax rate is impacted by existing tax laws in both the United States and in the respective countries in which our international subsidiaries do business. In addition, a decrease in the percentage of our total earnings from our international regions, or a change in the mix of international regions among particular tax jurisdictions, could increase our effective tax rate. Also, our current effective tax rate does not assume U.S. taxes on certain undistributed profits of certain foreign subsidiaries. These earnings could become subject to incremental foreign withholding or U.S. federal and state taxes should they either be deemed or actually remitted to the United States.

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Results of Operations

Fiscal Year

Our fiscal year is the 52- or 53-week period ending on the Friday nearest September 30. Fiscal year 2010 is the 52-week period ending October 1, 2010, and fiscal year 2009 was the 53-week period ended on October 2, 2009. The fiscal quarter ended January 1, 2010 was a 13-week period and the fiscal quarter ended January 2, 2009 was a 14-week period.

Discussion of Financial Data for the First Quarter of Fiscal Year 2010 Compared to the First Quarter of Fiscal Year 2009

Total Revenues

Revenues by sales classification	**Three Months Ended**		
(Dollars in millions)	**January 1, 2010**	**January 2, 2009**	**Percent Change**
Product	$ 410.2	$ 402.2	2%
Service Contracts and Other	130.7	106.5	23%
Total Revenues	$ 540.9	$ 508.7	6%
Product as a percentage of total revenues	*76%*	*79%*	
Service Contracts and Other as a percentage of total revenues	*24%*	*21%*	
Revenues by region			
North America	$ 227.8	$ 275.8	(17)%
Europe	193.0	130.8	48%
Asia	104.2	88.1	18%
Rest of world	15.9	14.0	13%
Total International (1)	313.1	232.9	34%
Total	$ 540.9	$ 508.7	6%
North America as a percentage of total revenues	*42%*	*54%*	
International as a percentage of total revenues	*58%*	*46%*	

(1) We consider international revenues to be revenues outside of North America.

Increased revenues in the first quarter of fiscal year 2010 over the first quarter of fiscal year 2009 was due to revenue growth in Oncology Systems, X-ray Products and Varian Particle Therapy, partially offset by a decline in SIP revenues. Oncology Systems and X-ray Products contributed to the growth in product revenues while SIP product revenues decreased. The increase in service contracts and other revenues was primarily driven by the increase in Oncology Systems service contract revenues and, to a lesser extent, an increase in Varian Particle Therapy service revenues.

North American revenues decreased in the first quarter of fiscal year 2010 from the first quarter of fiscal year 2009 primarily due to a decrease in Oncology Systems North American revenues and, to a lesser extent, decreases in SIP and X-ray Products North American revenues.

International revenues increased in the first quarter of fiscal year 2010 over the first quarter of fiscal year 2009, primarily due to increases in international revenues in Oncology Systems, X-ray Products and Varian Particle Therapy, which were partially offset by a decline in SIP international revenues. The weaker U.S. dollar against foreign currencies in the first quarter of fiscal year 2010 compared to the first quarter of

fiscal year 2009 favorably affected our international revenues when measured in U.S. dollars.

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Oncology Systems Revenues

Revenues by sales classification (Dollars in millions)	Three Months Ended January 1, 2010	January 2, 2009	Percent Change
Product	$ 306.4	$ 294.6	4%
Service Contracts (1)	123.7	103.6	19%
Total Oncology Systems revenues	$ 430.1	$ 398.2	8%
Product as a percentage of total Oncology Systems revenues	*71%*	*74%*	
Service Contracts as a percentage of Oncology Systems revenues	*29%*	*26%*	
Oncology Systems revenues as a percentage of total revenues	*79%*	*78%*	

(1) Revenues from service contracts represent revenues from fixed-term service contracts and labor cost services. This excludes revenues from spare parts sold by our service department.

For the first quarter of fiscal year 2010, Oncology Systems experienced increases in revenues from most of its product lines, including our software products, primarily in the international region, over the first quarter of fiscal year 2009. The increase in service contract revenues was primarily driven by increased customer adoption of service contracts as the sophistication of our products and the installed base of our products continue to increase. In addition, the weaker U.S. dollar against foreign currencies in the first quarter of fiscal year 2010 compared to the first quarter of fiscal year 2009 also favorably affected our international revenues when measured in U.S. dollars.

Revenues by region (Dollars in millions)	Three Months Ended January 1, 2010	January 2, 2009	Percent Change
North America	$ 196.7	$ 239.1	(18)%
Europe	162.6	104.4	56%
Asia	56.1	43.0	30%
Rest of world	14.7	11.7	26%
Total International	233.4	159.1	47%
Total Oncology Systems Revenues	$ 430.1	$ 398.2	8%
North America as a percentage of Oncology Systems revenues	*46%*	*60%*	
International as a percentage of Oncology Systems revenues	*54%*	*40%*	

Following weak North American net orders in fiscal year 2009, Oncology Systems North American revenues declined in the first quarter of fiscal year 2010 over the first quarter of fiscal year 2009, primarily due to revenue declines in most of its product lines slightly offset by revenue growth from Oncology Systems service contracts.

For the first quarter of fiscal year 2010, Oncology Systems international revenues grew significantly over the first quarter of fiscal year 2009 primarily due to an increase in sales of our high energy linear accelerators and an increase in service contracts revenues in all international regions. The weaker U.S. dollar against foreign currencies in the first quarter of fiscal year 2010 compared to the first quarter of fiscal year 2009 also favorably affected our international revenues when measured in U.S. dollars.

Varying cycles of higher and lower revenues between the international and North American regions is a historical pattern reflecting different technology adoption cycles and demand cycles that are consistent with the net order patterns discussed more fully under Net Orders. Oncology Systems revenues also continue to be influenced by the timing of product shipments in accordance with planned customer-requested delivery dates, and have been impacted by the effects of the recession, uncertainty created by the prospects of healthcare reform in the United States, and added uncertainty in late fiscal year 2009 about the proposed reduction in Medicare reimbursement rates for radiotherapy and radiosurgery at free-standing clinics in the United States and for physician reimbursement for radiation oncology.

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X-ray Products Revenues

Revenues by region (Dollars in millions)	Three Months Ended January 1, 2010	January 2, 2009	Percent Change
North America	$ 27.6	$ 28.9	(4)%
Europe	15.0	11.4	31%
Asia	47.6	43.4	10%
Rest of world	1.2	2.4	(49)%
Total International	63.8	57.2	11%
Total X-ray Products Revenues	$ 91.4	$ 86.1	6%
North America as a percentage of X-ray Products revenues	*30%*	*34%*	
International as a percentage of X-ray Products revenues	*70%*	*66%*	
X-ray Products revenues as a percentage of total revenues	*17%*	*17%*	

For the first quarter of fiscal year 2010, X-ray Products revenues grew 6% over the first quarter of fiscal year 2009 due to the growth in the international region, which was partially offset by a decline in revenues in North America, which continued to be impacted by the slowdown in the market for imaging equipment.

The increase in international revenues in the first quarter of fiscal year 2010 over the first quarter of fiscal year 2009 was primarily due to increased revenues from sales of our flat panel products in Europe, including our radiographic flat panels, and from sales of our x-ray tube products in Asia, partially offset by decreased revenues from sales of our x-ray tubes in Europe. In North America, the decrease in revenues resulted from a decline in sales of our x-ray tubes, which was partially offset by the growth in revenues from sales of our flat panel products, including our radiographic flat panels.

The general worldwide economic downturn we have seen since 2008 has made and may continue to make it difficult for our OEM customers to accurately forecast and plan future business activities. The market for new X-ray imaging equipment has been weak, and certain product lines, such as dental and veterinary, have been hit particularly hard in the recession. If the markets for our customers products significantly deteriorate due to the general economic downturn, our X-ray Products business may be adversely affected.

Other Revenues

Revenues by sales classification (Dollars in millions)	Three Months Ended January 1, 2010	January 2, 2009	Percent Change
Product	$ 12.4	$ 21.4	(42)%
Service Contracts	7.0	3.0	137%
Total Other revenues	$ 19.4	$ 24.4	(20)%
Other revenues as a percentage of total revenues	*4%*	*5%*	

Revenues in our Other category, which is comprised of SIP, Varian Particle Therapy and GTC, decreased in the first quarter of fiscal year 2010 over the first quarter of fiscal year 2009 primarily due to a decline in SIP product revenues, as a result of decreased sales of our Linatron products, partially offset by higher service revenues from Varian Particle Therapy related to the commissioning of a proton therapy system.

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Gross Margin

(Dollars in millions)	Three Months Ended January 1, 2010	Three Months Ended January 2, 2009	Percent Change
Dollar by segment			
Oncology Systems	$ 200.2	$ 173.9	15%
X-ray Products	37.6	34.7	9%
Other	3.2	10.4	(69)%
Gross margin	$ 241.0	$ 219.0	10%
Percentage by segment			
Oncology Systems	*46.5%*	*43.7%*	
X-ray Products	*41.2%*	*40.3%*	
Total Company	*44.6%*	*43.0%*	

The increase in total company gross margin percentage for the first quarter of fiscal year 2010 over the first quarter of fiscal year 2009 was primarily due to the improvements in Oncology Systems and X-ray Products gross margins, which were partially offset by the decreases in SIP and Varian Particle Therapy gross margins.

The increase in Oncology Systems gross margin was primarily due to the improvement in service contract gross margin and, to a lesser extent, an improvement in product gross margin. For the first quarter of fiscal year 2010, product gross margin was 42.8%, compared to 42.4% in the first quarter of fiscal year 2009, primarily as a result of higher product sale volume. Service contract gross margin increased to an unusually high 55.9% in the first quarter of fiscal year 2010 from 47.3% in the year-ago quarter, primarily as a result of higher service contract volume, cost control initiatives and lower quality costs in the first quarter of fiscal year 2010. The weaker U.S. dollar against foreign currencies in the first quarter of fiscal year 2010 compared to the first quarter of fiscal year 2009, which favorably affected our international revenues when measured in U.S. dollars, also benefited our Oncology Systems product and service gross margins in the first quarter of fiscal year 2010.

For the first quarter of fiscal year 2010, X-ray Products gross margin improved over the first quarter of fiscal year 2009 primarily due to product mix shift toward higher margin flat panel products.

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Research and Development

(Dollars in millions)	Three Months Ended January 1, 2010	January 2, 2009	Percent Change
Research and development	$ 38.4	$ 37.0	4%
As a percentage of total revenues	*7.1%*	*7.3%*	

The $1.4 million increase in research and development expense for the first quarter of fiscal year 2010 over the first quarter of fiscal year 2009 was driven by increased expenses of $2.3 million in Oncology Systems and $0.3 million in the Other category, partially offset by a decrease of $1.2 million in X-ray Products. The $2.3 million increase in Oncology Systems was attributable primarily to an increase in material costs and consulting expenses for product development, as well as a $1.3 million unfavorable currency translation impact, as foreign currency denominated research and development expenses for Oncology Systems were translated into weaker U.S. dollars. The $0.3 million increase in the Other category was primarily due to higher expense for development projects in Varian Particle Therapy, partially offset by a decrease in SIP research and development expenses. The $1.2 million decrease in X-ray Products was mainly due to lower development expenses for both x-ray tubes and flat panel products.

Selling, General and Administrative

(Dollars in millions)	Three Months Ended January 1, 2010	January 2, 2009	Percent Change
Selling, general and administrative	$ 83.5	$ 83.2	0%
As a percentage of total revenues	*15.4%*	*16.4%*	

Selling, general and administrative expenses remained flat in the first quarter of fiscal year 2010 compared to the first quarter of fiscal year 2009, primarily due to cost control initiatives. As a percentage of total revenues, selling, general and administrative expenses in the first quarter of fiscal year 2010 decreased one-percentage point from the year-ago period.

The $0.3 million increase in selling, general and administrative expenses for the first quarter of fiscal year 2010 compared to the first quarter of fiscal year 2009 was primarily attributable to: (a) an expense of $3.3 million related to a reduction in force that occurred in October 2009; (b) a $1.9 million increase in fees for certain commission arrangements and product promotions which were primarily tied to growth in Oncology Systems revenues; (c) unfavorable foreign currency impact of $1.6 million as the foreign currency denominated selling, general and administrative expenses of our foreign operations were translated into weaker U.S. dollars; (d) a $1.5 million increase in depreciation expenses for our enterprise resource planning system that was placed in service in the second quarter of fiscal year 2009; and (e) an increase in loss of $1.2 million from hedging balance sheet exposures from our various foreign subsidiaries and business units. These increases were partially offset by: (i) a decrease in information technology expenses of $3.7 million primarily due to the completion of the implementation of our enterprise resource planning system in the second quarter of fiscal year 2009; (ii) a $2.7 million net decrease in employee-related costs due to cost control initiatives; and (iii) a $2.6 million gain recognized as a result of the resolution of a contingency.

Interest Income (Expense), Net

(Dollars in millions)	Three Months Ended January 1, 2010	January 2, 2009	Percent Change
Interest income (expense), net	$ (0.3)	$ 1.3	(123)%

The decrease in interest income (expense), net, in the first quarter of fiscal year 2010 compared to the first quarter of fiscal year 2009 was primarily due to the lower average interest rates earned on our cash and cash equivalents.

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Taxes on Earnings

	Three Months Ended		
	January 1, 2010	January 2, 2009	Percent Change
Effective tax rate	34%	30%	4%

The increase in the Company s effective tax rate for the three-month period ended January 1, 2010 was primarily a result of the inclusion in the year-ago period of a greater net benefit for discrete items, primarily related to the release of certain liabilities for uncertain tax positions as a result of the lapse of the statutes of limitation in various jurisdictions, and the benefit of the retroactive reinstatement of the federal research and development credit.

In general, our effective income tax rate differs from the U.S. federal statutory rate primarily because our foreign earnings are taxed at rates that are, on average, lower than the U.S. federal rate, and our domestic earnings are subject to state income taxes. Our future effective tax rate could be adversely affected by having lower earnings than anticipated in countries where we have lower statutory rates and higher earnings than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets or liabilities, and by changes in tax laws or interpretations of those laws. For example, recent proposals would make significant changes to U.S. taxation of U.S.-based multinational corporations. Although we cannot predict whether or in what form Congress would enact any such proposals, legislation of this type could have an adverse impact on our effective tax rate. We also expect that our effective tax rate may experience increased fluctuation from period to period under the provisions in ASC 740 related to accounting for uncertainty in income taxes. Please refer to further discussion in Note 13 Income Taxes of the Notes to the Consolidated Financial Statements in our 2009 Annual Report.

Net Earnings Per Diluted Share

	Three Months Ended		
	January 1, 2010	January 2, 2009	Percent Change
Net earnings per diluted share	$ 0.63	$ 0.56	13%

The increase in earnings per diluted share in the first quarter of fiscal year 2010 over the first quarter of fiscal year 2009 resulted from (i) an increase in total revenues, (ii) an improvement in gross margin and (iii) leverage in our operating expenses, partially offset by an increase in our effective tax rate.

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Net Orders

Total Net Orders (by segment and region) (Dollars in millions)	Three Months Ended January 1, 2010	January 2, 2009	Percent Change
Oncology Systems:			
North America	$ 191.0	$ 220.5	(13)%
Total International	245.5	207.1	19%
Total Oncology Systems	$ 436.5	$ 427.6	2%
X-ray Products:			
North America	$ 10.7	$ 26.7	(60)%
Total International	88.3	64.4	37%
Total X-ray Products	$ 99.0	$ 91.1	9%
Other:	$ (39.9)	$ 32.6	(222)%
Total Net Orders:	$ 495.6	$ 551.3	(10)%

Net orders in the first quarter of fiscal year 2010, which included the reversal of a $62 million proton therapy system order from Skandion Kliniken, fell 10% compared to the first quarter of fiscal year 2009. When measured in constant currency, total net orders decreased 14%. Oncology Systems and X-ray Products recorded increases in net orders in the first quarter of fiscal year 2010 over the first quarter of fiscal year 2009, primarily as a result of net order growth in the international regions. Varian Particle Therapy, which recorded the $62 million proton therapy order reversal, and SIP reported net order decreases in the same period.

In the first quarter of fiscal year 2010, total Oncology Systems net order increased slightly over the first quarter of fiscal year 2009. Compared to the year-ago quarter, net orders for our Trilogy linear accelerators and Novalis Tx products for the hybrid market segment of radiosurgery in radiotherapy centers made up a higher proportion of net orders for our high energy accelerators in the first quarter of fiscal year 2010. The growth in Oncology Systems international net orders compared to the year-ago period was significantly offset by the decline in North American net orders compared to the year-ago period as North America continued to be impacted by the recession and the uncertainty created by the prospects of healthcare reform. Asia and Europe contributed to the growth in international net orders in the first quarter of fiscal year 2010 over the year-ago quarter, primarily due to increased demand for our high energy linear accelerators, while the rest of the world region experienced a decline. In North America, net orders decreased in most of Oncology Systems product lines in the first quarter of fiscal year 2010 compared to the first quarter of fiscal year 2009, while this region continued to experience growth in demand for service contracts. When measured in constant currency, total Oncology Systems net orders decreased 3% and international net orders grew 9% in the first quarter of fiscal year 2010 over the first quarter of fiscal year 2009.

The trailing 12 months growth in net orders for Oncology Systems at the end of the first quarter of fiscal year 2010 and at the end of the previous three fiscal quarters were: a 1% total decrease, with an 11% decrease in North America and an 11% increase for international regions, as of January 1, 2010; a 1% total increase, with a 7% decrease in North America and an 11% increase for international regions, as of October 2, 2009; an 8% total increase, with a 5% increase in North America and a 13% increase for international regions, as of July 3, 2009; a 12% total increase, with a 10% increase in North America and a 14% increase for international regions, as of April 3, 2009. Consistent with the historical pattern, we expect that Oncology Systems net orders will continue to experience regional fluctuations.

Net orders for X-ray Products in the international region grew 37% in the first quarter of fiscal year 2010 over the first quarter of fiscal year 2009 primarily as a result of increased demand for our flat panel products, including our radiographic flat panels, in Asia and Europe and increased demand for our x-ray tubes in Asia. In North America, X-ray Products net orders declined by 60% in the first quarter of fiscal year 2010 from the first quarter of fiscal year 2009, as orders for both the flat panel detectors and x-ray tubes continued to be impacted by the

slowdown in the market for imaging equipment. For the first time, orders for our flat panel detectors in the first quarter of 2010 exceeded orders for our x-ray tubes.

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In the first quarter of fiscal year 2010, net orders in the Other category declined $73 million from the first quarter of fiscal year 2009 primarily due to the cancellation of the $62 million proton therapy system order from Skandion Kliniken. We booked this order in the fourth quarter of fiscal year 2009 when Skandion Kliniken awarded us a contract to deliver and install a proton therapy system in Sweden following a public tender process, which was subsequently challenged by a competitor. After the Swedish court ruled in December 2009 that the tender should be recommenced, Skandion Kliniken cancelled the award with us January 2010. In accordance with our order booking policy, we removed this order from our backlog in the first fiscal quarter of 2010. SIP net orders also decreased during first quarter of fiscal year 2010 from very strong net orders in the first quarter of fiscal year 2009.

In any given period, orders growth in either North America or international regions, or both, could fluctuate because of the high dollar amount of individual orders. In addition, our net orders have been and may continue to be impacted by the current general economic downturn, which has shrunk capital equipment budgets, slowed decision-making, made financing for large equipment purchases more expensive and more time consuming, and made it difficult for our customers to accurately forecast and plan future business activities; as well as by uncertainty created by the prospects of healthcare reform in the United States. As the economy recovers and there is greater clarity on the impact of healthcare reform, we could experience a temporary increase in orders due to pent-up demand of customers, which in turn could increase the volatility of our orders and revenues. Orders in any quarter or period may not be directly correlated to the level of revenues in any particular future quarter or period since the timing of revenue recognition will vary significantly based on the delivery requirements of individual orders, acceptance schedules and the readiness of individual customer sites for installation of our products. Moreover, certain types of orders, such as software products or newly introduced products in our Oncology Systems segment, typically take more time from order to completion of installation and acceptance. Thus, as the overall mix of net orders includes a greater proportion of these types of products, the average time period within which orders convert into revenues could lengthen and our revenue in a specific period could be lower as a result.

Discontinued Operations

In the fourth quarter of fiscal year 2008, we approved a plan to sell Research Instruments to focus the business that we acquired from ACCEL exclusively on the development of our Varian Particle Therapy business. The sale of Research Instruments was completed in the second quarter of fiscal year 2009. Research Instruments has been classified as a discontinued operation in our Condensed Consolidated Statements of Earnings for all periods presented. Research Instruments was previously included in the Other category. Revenues from Research Instruments were $0.1 million and $4.2 million for the first quarter of fiscal years 2010 and 2009, respectively. Research Instruments did not have any profit or loss in the first quarter of fiscal year 2010 and net loss from Research Instruments was $0.8 million for the first quarter of fiscal 2009. See Note 16, Discontinued Operations to the Condensed Consolidated Financial Statements for a detailed discussion.

Backlog

At January 1, 2010, our backlog was $2.0 billion, which is an increase of 4% over the backlog at January 2, 2009. Our Oncology Systems backlog at January 1, 2010 was 4% higher than the backlog at January 2, 2009, which reflects a 2% increase for North America and an 8% increase for the international regions.

Liquidity and Capital Resources

Liquidity is the measurement of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, acquire businesses and fund continuing operations. Our sources of cash have included operations, borrowings, stock option exercises and employee stock purchases (although our employee stock purchase plan is currently suspended) and interest income. Our cash usage is actively managed on a daily basis to ensure the maintenance of sufficient funds to meet our needs. Because Research Instruments cash flows were not material for any period presented, we have not segregated them from continuing operations on our Condensed Consolidated Statements of Cash Flows and the discussion herein.

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Cash and Cash Equivalents

The following table summarizes our cash and cash equivalents:

(In millions)	January 1, 2010	October 2, 2009	Increase/ (Decrease)
Cash and cash equivalents	$ 625	$ 554	$ 71

Our cash and cash equivalents increased $71 million from $554 million at October 2, 2009 to $625 million at January 1, 2010. The increase in cash and cash equivalents in the first quarter of fiscal year 2010 was due primarily to $131 million of cash generated from operating activities, $9 million of cash provided by stock option exercises and $1 million of cash provided by the excess tax benefits from share-based compensation. These increases were partially offset by $55 million used for the repurchase of VMS common stock, $8 million of capital expenditures and $2 million used for a loan advance to dpiX LLC (dpiX). In addition, foreign currency exchange rate changes in the first quarter of fiscal year 2010 increased cash and cash equivalents by $2 million.

At January 1, 2010, we had approximately $69 million, or 11%, of total cash and cash equivalents in the United States. Approximately $556 million, or 89%, of total cash and cash equivalents was held abroad and could be subject to additional taxation if it were repatriated to the United States. As of January 1, 2010, most of our cash and cash equivalents that were held abroad were in U.S. dollars. Because our cash levels in the United States are relatively low, we have used our credit facility to meet our cash needs from time to time and expect to continue to do so in the future. Borrowings under our credit facility may be used for working capital, capital expenditures, acquisitions and other corporate purposes.

Cash Flows

	Three Months Ended	
(In millions)	January 1, 2010	January 2, 2009
Net cash flow provided by (used in):		
Operating activities	$ 131	$ 85
Investing activities	(16)	(22)
Financing activities	(46)	(40)
Effects of exchange rate changes on cash and cash equivalents	2	3
Net increase in cash and cash equivalents	$ 71	$ 26

Our primary cash inflows and outflows for the first three months of fiscal year 2010, as compared to the first three months of fiscal year 2009, were as follows:

In the first three months of fiscal year 2010, we generated net cash from operating activities of $131 million, compared to $85 million for the first three months of fiscal year 2009.

The $46 million increase in net cash from operating activities during the first three months of fiscal year 2010 compared to the first three months of fiscal year 2009 was driven primarily by a net change of $34 million in operating assets and liabilities (working capital items), an increase of $10 million in net earnings and an increase in non-cash items of $2 million.

The major contributors to the net change in working capital items in the first three months of fiscal year 2010 were accounts receivable, inventories and advance payments from customers as follows:

Accounts receivable decreased $69 million due to lower revenues in the first quarter of fiscal year 2010 compared to the fourth quarter of fiscal year 2009, as well as strong collection performance in the first quarter of fiscal year 2010. We historically experience strong fourth quarter revenues.

Inventories increased by $40 million due to anticipated customer demand for products during fiscal year 2010.

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Advance payments from customers increased by $27 million due to the timing of down payments received.

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, timing of product shipments and customer acceptance, accounts receivable collections, inventory management and the timing and amount of tax and other payments. For additional discussion, please refer to the Risk Factors in Item 1A.

We used $16 million for investing activities in the first three months of fiscal year 2010, compared to $22 million used in the first three months of fiscal year 2009. Cash used for purchases of property, plant and equipment was $8 million for the first three months of fiscal year 2010 and $18 million for the first three months of fiscal year 2009. We made an additional loan advance of $2 million to dpiX in the first three months of fiscal year 2010.

Financing activities used net cash of $46 million in the first three months of fiscal year 2010 compared to $40 million in the first three months of fiscal year 2009. During the first three months of fiscal year 2010, we used $55 million to repurchase shares of VMS common stock. Partially offsetting these uses were proceeds of $9 million from employee stock option exercises, and $1 million in excess tax benefits from share-based compensation. During the first three months of fiscal year 2009, we used $72 million to repurchase shares of VMS common stock. Partially offsetting this use were $25 million in net borrowing under our credit facility, proceeds of $4 million from employee stock option exercises and $3 million in excess tax benefits from share-based compensation.

We expect our capital expenditures, which typically represent construction and/or purchases of facilities, manufacturing equipment, office equipment and furniture and fixtures, as well as capitalized costs related to the implementation of software applications, will be approximately 3.7% of revenues in fiscal year 2010.

We have a $150 million credit facility with Bank of America, N.A. (BofA), which was amended and restated in November 2008 and in July 2009. This credit facility, as amended and restated, is referred to as the Amended BofA Credit Facility . The July 2009 amendment to the Amended BofA Credit Facility (the Japanese Line of Credit) enabled VMS s Japanese subsidiary (VMS KK) to borrow up to 2.7 billion Japanese Yen. At any time amounts are outstanding under the Japanese Line of Credit, the full borrowing capacity under the Japanese Line of Credit is deemed committed for use in Japan and therefore the maximum amount VMS can otherwise borrow under the Amended BofA Credit Facility will be reduced by $30 million to $120 million. VMS guarantees the payment of the outstanding balance under the Japanese Line of Credit. We collateralized a portion of the Amended BofA Credit Facility with a pledge of stock of certain present and future subsidiaries that are deemed to be material subsidiaries under its terms. As of January 1, 2010, we had pledged to BofA 65% of the voting shares that we hold in Varian Medical Systems Nederland B.V., a wholly-owned subsidiary.

The Amended BofA Credit Facility may be used for working capital, capital expenditures, permitted acquisitions and other lawful corporate purposes. Borrowings under the Japanese Line of Credit can be used by VMS KK for refinancing certain intercompany debts, working capital, capital expenditures and other lawful corporate purposes. Borrowings under the Amended BofA Credit Facility (outside of the Japanese Line of Credit) accrue interest either (i) based on LIBOR plus a margin of 1.25% to 1.50% based on a leverage ratio involving funded indebtedness and earnings before interest, taxes, depreciation and amortization (EBITDA) or (ii) based upon a base rate of either the federal funds rate plus 0.5% or BofA s announced prime rate, whichever is greater, minus a margin of 0.5% to 0% based on a leverage ratio involving funded indebtedness and EBITDA (depending upon our instructions to BofA). We may select borrowing periods of one, two, three or six months for advances based on the LIBOR rate. Interest rates on advances based on the base rate are adjustable daily. Borrowings under the Japanese Line of Credit accrue interest at the basic loan rate announced by the Bank of Japan plus a margin of 1.25% to 1.50% based on a leverage ratio involving funded indebtedness and EBITDA. The Amended BofA Credit Facility will expire, if not extended by mutual agreement of VMS and BofA, on November 10, 2011. The Japanese Line of Credit will expire on November 10, 2010.

As of January 1, 2010, there was no outstanding balance under the Amended BofA Credit Facility other than $4.3 million outstanding under the Japanese Line of Credit with a weighted average interest rate of 1.55%. The Amended BofA Credit Facility contains customary affirmative and negative covenants for facilities of this type. We have also agreed to maintain certain financial covenants relating to (i) leverage ratios involving funded indebtedness and EBITDA, (ii) liquidity and (iii) consolidated assets. As of January 1, 2010, we were in compliance with all covenants. For further discussion regarding the credit facilities, please refer to Note 7 Credit Facility to the Condensed Consolidated Financial Statements.

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Our liquidity is affected by many factors, some of which result from the normal ongoing operations of our business and some of which arise from uncertainties and conditions in the United States and global economies. Although our cash requirements will fluctuate as a result of the shifting influences of these factors, we believe that existing cash and cash equivalents and cash to be generated from operations and current or future credit facilities will be sufficient to satisfy anticipated commitments for capital expenditures and other cash requirements for the next 12 months. We currently anticipate that we will continue to utilize our available liquidity and cash flows from operations, as well as borrowed funds, to make strategic acquisitions, invest in the growth of our business, invest in advancing our systems and processes and repurchase VMS common stock.

Total debt as a percentage of total capital decreased to 2.6% at January 1, 2010 from 2.7% at October 2, 2009. The ratio of current assets to current liabilities increased to 2.02 to 1 at January 1, 2010 from 1.99 to 1 at October 2, 2009.

Days Sales Outstanding

Trade accounts receivable days sales outstanding (DSO) were 84 days at January 1, 2010 compared to 83 days at January 2, 2009. Our accounts receivable and DSO are primarily impacted by a number of factors, including: the timing of product shipments; collections performance; payment terms; and the mix of revenues from different regions. As of January 1, 2010, less than 1% of our accounts receivable balance was related to customer contracts with extended payment terms of more than one year.

Stock Repurchase Program

On November 17, 2008, VMS s Board of Directors authorized the repurchase of 8,000,000 shares of VMS common stock from January 1, 2009 through December 31, 2009. During the three months ended January 1, 2010, we paid $55.2 million to repurchase 1,250,000 shares of VMS common stock. All shares that have been repurchased have been retired. The November 17, 2008 authorization expired on December 31, 2009 with 6,050,000 shares available for repurchase. On November 13, 2009, VMS s Board of Directors authorized the repurchase of an additional 5,000,000 shares of VMS common stock from January 1, 2010 through December 31, 2010.

Contractual Obligations

Long-term income taxes payable includes the liability for uncertain tax positions (including interest and penalties) and may also include other long-term tax liabilities. As of January 1, 2010, our liability for uncertain tax positions was $67.2 million. We believe that existing cash and cash equivalents and cash to be generated from operations and current or future credit facilities will be sufficient to satisfy any payment obligations that may arise related to our liability for uncertain tax positions.

In February 2009, we agreed to loan $14 million to dpiX in four separate installments over a period through the first half of fiscal year 2010. As of January 1, 2010, we had loaned $8.8 million to dpiX under this loan agreement and we expect to loan the remaining $5.2 million in fiscal year 2010. Please refer to the more detailed discussion in Note 5, Related Party Transactions to the Consolidated Financial Statements.

Except for the items discussed above and the change in the outstanding balance under our credit facility, there has been no significant change to the other contractual obligations we reported in our 2009 Annual Report.

Contingencies

Environmental Remediation Liabilities

For a discussion of environmental remediation liabilities, see Note 9, Commitments and Contingencies - Environmental Remediation Liabilities to the Condensed Consolidated Financial Statements, which discussion is incorporated herein by reference.

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Acquisition-Related Commitments/Obligations

When we acquired ACCEL in January 2007, ACCEL was involved in a contract-related lawsuit, which we settled by agreeing to perform certain services for a fixed price contract (the Fixed Price Contract). As of October 2, 2009, we had recorded a loss accrual of 7.6 in relation to Fixed Price Contract. In the first quarter of fiscal year 2010, we entered into a new contract (the New Contract) to perform certain services for a fixed price and we recorded a loss accrual of 0.9 million in connection with the New Contract. As of January 1, 2010, the balance of the loss accrual related to this contingency was 0.8 million. If the actual costs related to the contingency exceed the estimated amount or if the estimated loss increases, the variances will be recognized in the Consolidated Statement of Earnings in the periods these variances arise.

Other Matters

We are involved, from time to time, in legal proceedings, claims and government inspections or investigations, arising in the ordinary course of our business. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. We accrue amounts, to the extent they can be reasonably estimated, that we believe are adequate to address any liabilities related to legal proceedings and other loss contingencies that we believe will result in a probable loss. While we cannot assure you as to the ultimate outcome of any legal proceeding or other loss contingency involving us, management does not believe any pending matter will be resolved in a manner that would have a material adverse effect on our consolidated financial position, results of operations or cash flows. However, it is possible that a legal or other proceeding brought against us could have an impact of this nature.

Off-Balance Sheet Arrangements

In conjunction with the sale of our products in the ordinary course of business, we provide standard indemnification of business partners and customers for losses suffered or incurred for property damages, death and injury and for patent, copyright or any other intellectual property infringement claims by any third parties with respect to our products. The term of these indemnification arrangements is generally perpetual. Except for losses related to property damages, the maximum potential amount of future payments we could be required to make under these agreements is unlimited. As of January 1, 2010, we have not incurred any significant costs to defend lawsuits or settle claims related to these indemnification arrangements since we spun off Varian Inc. and Varian Semiconductor Equipment Associates, Inc. in 1999.

We have entered into indemnification agreements with our directors and officers and certain of our employees that serve as officers or directors of our foreign subsidiaries that may require us to indemnify our directors and officers and those certain employees against liabilities that may arise by reason of their status or service as directors or officers, and to advance their expenses incurred as a result of any legal proceeding against them as to which they could be indemnified. Generally, the maximum obligation under these indemnifications is not explicitly stated and, as a result, the overall amount of these obligations cannot be reasonably estimated.

Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued new accounting standards for business combinations under ASC 805, which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. The new standards also establish disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. In April 2009, the FASB issued additional standards under ASC 805-20 to clarify initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. We adopted the new standards related to business combinations under ASC 805 at the beginning of fiscal year 2010. The impact of the adoption of these new standards depends on the nature and extent of business combinations occurring on or after the beginning of fiscal year 2010. We did not acquire any business in the first quarter of fiscal year 2010.

In December 2007, the FASB established new accounting and reporting standards under ASC 810 for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent s ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. The new accounting standards under ASC 810 also establish disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. We adopted the new standards under ASC 810 at the beginning of fiscal year 2010. The adoption of these new standards under ASC 810 had no impact on our consolidated financial position, results of operations or cash flows.

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In November 2008, the FASB ratified an Emerging Issues Task Force (EITF) Issue, which clarifies the accounting for certain transactions and impairment considerations involving equity method investments. We adopted the new standards, which are included in ASC 323-10 at the beginning of fiscal year 2010. The adoption of this new standard did not have a material impact on our consolidated financial position, results of operations or cash flows.

In August 2009, the FASB issued an update to ASC 820. This Accounting Standards Update (ASU) No. 2009-5, Measuring Liabilities at Fair Value (ASU 2009-5) amends the provisions in ASC 820 related to the fair value measurement of liabilities and clarifies valuation techniques in circumstances in which a quoted price in an active market for the identical liability is not available. ASU 2009-5 is intended to reduce potential ambiguity in financial reporting when measuring the fair value of liabilities. We adopted ASU 2009-5 at the beginning of fiscal year 2010. The adoption of ASU 2009-5 concerns disclosure only and did not have an impact on the Company s consolidated financial position, results of operations or cash flows.

In December 2008, the FASB issued new standards under ASC 715-20, which provides guidance on an employer s disclosure about plan assets of a defined benefit pension or other post-retirement plan and requires employers to disclose information about fair value measurements of plan assets. The new standards under ASC 715-20 will be effective for us as of the end of fiscal year 2010. The adoption of these new standards concerns disclosure only and we do not expect it to have an impact on our consolidated financial position, results of operations or cash flows.

In June 2009, the FASB issued the consolidation guidance for variable-interest entities to replace the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable-interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable-interest entity that most significantly impact the entity s economic performance. These new standards will be effective for us in the first quarter of fiscal year 2011. We are currently assessing the potential impact, if any, these new standards may have on our consolidated financial position, results of operations and cash flows.

In October 2009, the FASB issued an update to ASC 605. This ASU No. 2009-13, *Multiple Deliverable Revenue Arrangements* (ASU 2009-13), provides guidance on whether multiple deliverables in a revenue arrangement exist, how the arrangement should be separated and how the consideration should be allocated. ASU 2009-13 eliminates the requirement to establish the fair value of undelivered products and services and instead provides for separate revenue recognition based upon management s estimate of the selling price for an undelivered item when there is no other means to determine the fair value of that undelivered item. ASU 2009-13 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted if we elect to adopt ASU No. 2009- 14, *Certain Revenue Arrangements That Include Software Elements* (ASU 2009-14) concurrently. We are currently evaluating the potential impact of ASU 2009-13 on our consolidated financial position, results of operations and cash flows.

In October 2009, the FASB issued an update to ASC 985-605. This ASU 2009-14, amends the scope of the software revenue guidance in ASC 985-605 to exclude tangible products containing software components and non-software components that function together to deliver the tangible product s essential functionality. ASU 2009-14 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted if we elect to adopt ASU 2009-13 concurrently. We are currently evaluating the potential impact of ASU 2009-14 on our consolidated financial position, results of operations and cash flows.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to three primary types of market risks: credit risk, foreign currency exchange rate risk and interest rate risk.

Credit Risk

There has been significant deterioration and instability in the financial markets beginning in fiscal year 2008. This period of extraordinary disruption and readjustment in the financial markets exposes us to additional credit risk. We are exposed to credit loss in the event of nonperformance by counterparties on the foreign exchange contracts used in hedging activities. These counterparties are large international financial institutions and to date, no such counterparty has failed to meet its financial obligation under such contracts. In addition, cash and cash equivalents held with financial institutions may exceed the Federal Deposit Insurance Corporation insurance limits or similar limits in foreign jurisdictions. We also have the credit facility described below. Our access to our cash and cash equivalents or ability to borrow could be reduced if one or more financial institutions with which we have deposits or from which we borrow should fail or otherwise be adversely impacted by conditions in the financial or credit markets.

Foreign Currency Exchange Rate Risk

As a global entity, we are exposed to movements in foreign currency exchange rates. These exposures may change over time as business practices evolve. Adverse movements could have a material negative impact on our financial results. Our primary exposures related to foreign currency denominated sales and purchases are in Europe, Asia, Australia and Canada.

We have many transactions denominated in foreign currencies and address certain of those financial exposures through a risk management program that includes the use of derivative financial instruments. We sell products throughout the world, often in the currency of the customer s country, and may hedge certain of these larger foreign currency transactions when they are not transacted in the subsidiaries functional currency. The foreign currency sales transactions that fit our risk management policy criteria are hedged with forward contracts. We may use other derivative instruments in the future. We enter into foreign currency forward contracts primarily to reduce the effects of fluctuating foreign currency exchange rates. We do not enter into forward contracts for speculative or trading purposes. The forward contracts range from one to twelve months in maturity.

We also hedge the balance sheet exposures from our various foreign subsidiaries and business units. We enter into foreign currency forward contracts to minimize the short-term impact of currency fluctuations on assets and liabilities denominated in currencies other than the U.S. dollar functional currency.

The notional values of our sold and purchased foreign currency forward contracts outstanding as of January 1, 2010 were $267.5 million and $65.2 million, respectively. The notional amounts of forward contracts are not a measure of our exposure. The fair value of forward contracts generally reflects the estimated amounts that we would receive or pay to terminate the contracts at the reporting date, thereby taking into account and approximating the current unrealized and realized gains or losses of the open contracts. A move in foreign currency exchange rates would change the fair value of the contracts, and the fair value of the underlying exposures hedged by the contracts would change in a similar offsetting manner.

Interest Rate Risk

Our market risk exposure to changes in interest rates depends primarily on our investment portfolio and short-term borrowings. Our investment portfolio consisted of cash and cash equivalents as of January 1, 2010. The principal amount of cash and cash equivalents at January 1, 2010 totaled $625 million with a weighted average interest rate of 0.17%.

The Amended BofA Credit Facility (including the Japanese Line of Credit) allows us to borrow up to a maximum amount of $150 million. We collateralized a portion of the Amended BofA Credit Facility with a pledge of 65% of the voting shares that we hold in Varian Medical Systems Nederland B.V., a wholly-owned subsidiary. Borrowings under the Amended BofA Credit Facility (outside of the Japanese Line of Credit) accrue interest based on the LIBOR, the federal funds rate, or the BofA s prime rate plus a margin. Borrowings under the Japanese Line of Credit accrue interest at the basic loan rate announced by the Bank of Japan plus a margin.

We are affected by market risk exposure primarily through the effect of changes in interest rates on amounts payable under the Amended BofA Credit Facility (including the Japanese Line of Credit). As of January 1, 2010, the amount outstanding under the Amended BofA Credit Facility was the $4.3 million in principal under the Japanese Line of Credit. If the amount outstanding under the Japanese Line of Credit remained at this level for an entire year and the basic loan rate increased or

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decreased, respectively, by 1%, our interest expense would increase or decrease, respectively, by an additional $43,000. See a detailed discussion of our credit facility under Liquidity and Capital Resources section in Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations.

In addition, we had $32.3 million of long-term debt (including the current maturities of long-term debt) outstanding as of January 1, 2010 that carried at a weighted average fixed interest rate of 6.9% with principal payments due in various installments over a four-year period. To date, we have not used derivative financial instruments to hedge the interest rate of our investment portfolio, short-term borrowings or long-term debt, but may consider the use of derivative instruments in the future.

The estimated fair value of our cash and cash equivalents (89% of which was held abroad at January 1, 2010 and could be subject to additional taxation if it were repatriated to the United States) and the estimated fair value of our short-term borrowings under the credit facility approximated the principal amounts reflected above based on the maturities of these financial instruments.

Although payments under certain of our operating leases for our facilities are tied to market indices, these operating leases do not expose us to material interest rate risk.

Item 4. Controls and Procedures

(a) Disclosure controls and procedures. Based on the evaluation of our disclosure controls and procedures (as defined in the Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) required by Exchange Act Rules 13a-15(b) or 15d-15(b), our principal executive officer and principal financial officer have concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including the principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in internal control over financial reporting. There were no changes in our internal control over financial reporting that occurred during the first quarter of fiscal year 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II

OTHER INFORMATION

Item 1. Legal Proceedings

We are subject to various legal proceedings and claims that are discussed in Note 9, Commitments and Contingencies to the Condensed Consolidated Financial Statements, which discussion is incorporated by reference into this item.

Item 1A. Risk Factors

The following risk factors and other information included in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the fiscal year ended October 2, 2009 should be carefully considered. Although the risk factors described below are the ones management deems significant, additional risks and uncertainties not presently known to us or that we presently deem less significant may also impair our business operations. If any of the following risks actually occur, our business, operating results, and financial condition could be adversely affected.

IF WE ARE UNABLE TO ANTICIPATE OR KEEP PACE WITH CHANGES IN THE MARKETPLACE AND THE DIRECTION OF TECHNOLOGICAL INNOVATION AND CUSTOMER DEMANDS, OUR PRODUCTS MAY BECOME LESS USEFUL OR OBSOLETE AND OUR OPERATING RESULTS WILL SUFFER

Rapid change and technological innovation characterize the Oncology Systems market. Our products often have long development and government approval cycles, so we must anticipate changes in the marketplace, in technology and in customer demands. For example, most of our recent Oncology Systems product introductions have related to IMRT, IGRT, and VMAT, and enhancements of existing products through greater integration and simplification.

We believe that IMRT and IGRT have become accepted standards for treatment in the radiation oncology market. Demand for our IMRT products has been a historical driver for our net orders and revenues in Oncology Systems and, now, demand for our products for IGRT has been one of the main contributors to more recent net orders and revenue growth. However, if future studies call into question the effectiveness of our IMRT or IGRT products or show negative side effects, or if other more effective technologies are introduced, our revenues could suffer. Our success also depends on the continued acceptance and success of IMRT and IGRT in general and of our IMRT and IGRT products in particular. As more institutions buy or upgrade to achieve these capabilities, the market for IMRT and IGRT products may become saturated and we could face competition from newer technologies. For example, we have seen and continue to expect that the rate of growth for IMRT equipment will be lower than what we have experienced previously, particularly in the North American market where a majority of our customer sites have the products and accessories necessary to perform IMRT.

We believe that the acceptance of VMAT in general, and our RapidArc products in particular, is key to our future success. We believe that our RapidArc products for VMAT are a significant advance in IMRT treatments and can help drive longer term demand for our linear accelerators and IMRT-related products. Orders for our RapidArc technology have contributed significantly to our recent net orders growth, even though VMAT and our RapidArc products are not yet widely-accepted as a treatment standard. Early adopters of VMAT and our RapidArc products continue to publish studies on VMAT treatments using our RapidArc products. If, however, future studies contradict current knowledge about VMAT or our RapidArc products, question the effectiveness of VMAT treatments or show negative side effects, or if other more effective technologies are introduced, our customers may not be willing to adopt VMAT or purchase our RapidArc products. In addition, if third party information systems do not support our VMAT technology, customers that have third party information systems may not purchase our RapidArc products, which could negatively impact our net orders and revenues.

As radiation oncology treatment becomes more complex, our customers are increasingly focusing on ease-of-use and interconnectivity. Our equipment and software is highly sophisticated and requires a high level of training and education to use them competently and safely, a requirement made even more important because they work together within integrated environments. We have directed substantial product development efforts into (i) greater interconnectivity of our products for more seamless operation within a system, (ii) enhancing the ease of use of our software products and (iii) reducing setup and treatment times and increasing patient throughput. We have emphasized maintaining an open systems approach that allows customers to mix and match individual products, incorporate products from other manufacturers, share information with other systems or products and use the equipment for offering various methods of radiation therapy treatment. We anticipate that these efforts will increase the acceptance and adoption of IMRT, VMAT and IGRT and will stimulate demand for our products from new customers and upgrades from existing customers. We face competition though from closed-ended

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dedicated-use systems that place simplicity of use ahead of flexibility. If we have misjudged the importance to our customers of maintaining an open systems approach, or if we are unsuccessful in our efforts to enable greater interconnectivity, enhance ease-of-use and reduce setup and treatment times, our revenues could suffer.

The acquisition of Varian Particle Therapy should enable us to develop and offer products for delivering image-guided, intensity-modulated proton therapy for the treatment of cancer. While our investment in proton therapy product development will continue, this technology may not be accepted as quickly as others due to the relatively large scale, high costs and complex project financing associated with implementing a proton therapy system. Risks associated with this business could increase, given the heavy reliance of customers on credit and large-scale project financing, which is more difficult to obtain with the current general worldwide economic downturn and contraction in credit markets. Our future success will depend upon the wide-spread awareness, acceptance and adoption by the oncology market of proton therapy systems for the treatment of cancer. Our efforts to increase awareness and adoption of our proton therapy systems may not be successful, which could negatively impact this business.

Our X-ray Products business sells products primarily to a small number of imaging system OEM customers who use our products in their medical diagnostic and industrial imaging systems. Some of these companies also manufacture x-ray tubes or flat panel detectors for their own systems, which means that we compete with their in-house x-ray tube and flat panel detector manufacturing operations for business from their affiliated systems businesses. To succeed, we must provide x-ray tube and flat panel detector products that meet customer demands for lower cost, better product quality and superior technology and performance. If we are unable to continue to innovate our X-ray Products technology and anticipate our customers demands in the areas of cost, quality, technology and performance, then our customers may chose to purchase from their internal manufacturing operations or from other independent tube or panel manufacturers, which would negatively impact this business.

We may be unable to accurately anticipate changes in our markets and the direction of technological innovation and demands of our customers, our competitors may develop improved products or processes, or the marketplace may conclude that the tasks our products were designed to do is no longer an element of a generally accepted diagnostic or treatment regimen. If this occurs, the market for our products may be adversely affected and they may become less useful or obsolete. Any development adversely affecting the markets for our products would force us to reduce production volumes or to discontinue manufacturing one or more of our products or product lines and would reduce our revenues and earnings.

IF WE ARE UNABLE TO DEVELOP NEW PRODUCTS OR ENHANCE EXISTING PRODUCTS, WE MAY BE UNABLE TO ATTRACT OR RETAIN CUSTOMERS

Our success depends on the successful development, introduction and commercialization of new generations of products, treatment systems and enhancements to and/or simplification of existing products. Our Oncology Systems products are technologically complex and must keep pace with, among other things, those of our competitors. Our X-ray Products business must also continually develop improved and lower cost products. Accordingly, many of our products may require significant planning, design, development and testing. We are making significant investments in long-term growth initiatives, such as development of our SIP and Particle Therapy businesses, and expect that we will need more investment to develop and commercialize the products and technology for these businesses. These activities require significant capital commitments, involvement of senior management and other investments on our part, which we may be unable to recover. Our timeline for the development of new products or enhancements may not be achieved and price and profitability targets may not prove feasible. Commercialization of new products may prove challenging, and we may be required to invest more time and money than expected to successfully introduce them. Once introduced, new products may adversely impact orders and sales of our existing products, or make them less desirable or even obsolete. Compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of new products or enhancements. A few of our research and development projects have been, and in the future may be, funded by government contracts, and changes in government priorities and our ability to attract similar funding may affect our overall research efforts.

Our ability to successfully develop and introduce new products, treatment systems and product enhancements and simplifications, and the revenues and costs associated with these efforts, are affected by our ability to:

- properly identify customer needs;
- prove feasibility of new products;

limit the time required from proof of feasibility to routine production;

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comply with internal quality assurance systems and processes timely and efficiently;

limit the timing and cost of regulatory approvals;

accurately predict and control costs associated with inventory overruns caused by phase-in of new products and phase-out of old products;

price our products competitively;

manufacture and deliver our products in sufficient volumes on time, and accurately predict and control costs associated with manufacturing, installation, warranty and maintenance of the products;

manage customer acceptance and payment for products;

manage customer demands for retrofits of both new and old products; and

anticipate and compete successfully with competitors.

Additionally, the budgeting cycles of hospitals and clinics for capital equipment purchases are frequently fixed well in advance and have experienced pressure during the economic downturn, which may lengthen sales and ordering timeframes. In addition, even if customers accept new products or product enhancements, the revenues from these products may not be sufficient to offset the significant costs associated with making them available to customers.

We cannot be sure that we will be able to successfully develop, manufacture or introduce new products, treatment systems or enhancements, the roll-out of which involves compliance with complex quality assurance processes, including the Quality System Regulation (QSR) of the Food and Drug Administration (FDA). Failure to complete these processes timely and efficiently could result in delays that could affect our ability to attract and retain customers, or could cause customers to delay or cancel orders, causing our revenues and operating results to suffer.

New products generally take longer to install than well-established products. Because a portion of a product s revenue is generally tied to installation and acceptance of the product, our recognition of revenue associated with new products may be deferred longer than expected. While we will work to decrease the installation times for new products, such as we have done with installation times for our On-Board Imager® (OBI), these plans may not be successful or have a meaningful impact on reducing associated revenue recognition deferrals. Furthermore, even if these plans are successful, potential customers may not decide to upgrade their equipment, or customers may delay delivery of some of our more sophisticated products because of the longer preparation and renovation of treatment rooms required. As a result, our revenues and other financial results could be adversely affected.

ROUGHLY HALF OF OUR REVENUES ARE INTERNATIONAL, AND ECONOMIC, POLITICAL AND OTHER RISKS ASSOCIATED WITH INTERNATIONAL SALES AND OPERATIONS COULD ADVERSELY AFFECT OUR SALES OR MAKE THEM LESS PREDICTABLE

We conduct business globally. Our international revenues accounted for approximately 58% and 46% of revenues from continuing operations during the first quarter of fiscal years 2010 and 2009, respectively. As a result, we must provide significant service and support globally, and we have sales and service offices located in Europe, Asia, South America and Australia. We also have manufacturing and research operations in the United Kingdom, Germany, Switzerland, France, Finland, Canada and China. We have invested, and will continue to invest, substantial resources to meet the needs of our customers. We intend to continue to expand our presence in international markets, although we cannot be sure we will be able to compete successfully in the international markets, generate new business, or meet the service and support needs of our customers there. Accordingly, our future results could be harmed by a variety of factors, including:

the difficulties in enforcing agreements and collecting receivables through many foreign country s legal systems;

the longer payment cycles associated with many foreign customers;

the possibility that foreign countries may impose additional taxes, tariffs or other restrictions on foreign trade;

the fact that international regions typically have a lower gross margin on our products and a longer period from shipment to revenue recognition that generally results in greater revenue recognition deferrals and higher backlog;

our ability to obtain export licenses and other required export or import licenses or approvals;

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failure to comply with export laws and requirements which may result in civil or criminal penalties and restrictions on our ability to export our products, particularly our industrial linear accelerator products;

failure to obtain proper business licenses or other documentation, or to otherwise comply with local laws and requirements regarding marketing, sales, service or any other business we conduct in a foreign jurisdiction, which may result in civil or criminal penalties and restrictions on our ability to conduct business in a foreign jurisdiction;

changes in the political, regulatory, safety or economic conditions in a country or region; and

the possibility that it may be more difficult to protect our intellectual property in foreign countries.

Historically, our international sales have had lower average selling prices and gross margins. Although our orders and sales fluctuate from period to period, in recent years our international regions have represented a larger share of our business. As a result, our overall rate of orders growth (measured in U.S. dollars) could slow down and overall revenues and gross margins may be negatively affected.

In addition, we generally retain cash received through international operations in our local subsidiaries. As of January 1, 2010, 89% of our cash and cash equivalents were held abroad. If these funds were repatriated to the United States, they could be subject to additional taxation, and we would not receive the full benefit of the repatriation. If this happens, our overall tax rate and our results of operations could suffer.

Earnings from our international regions are generally taxed at rates lower than U.S. rates. Our effective tax rate is impacted by tax laws in both the United States and in the respective countries in which our international subsidiaries do business. A decrease in the percentage of our total earnings from international regions, or a change in the mix of international regions among particular tax jurisdictions, could increase our effective tax rate. Also, our current effective tax rate does not assume U.S. taxes on certain undistributed profits of certain foreign subsidiaries. These earnings could become subject to incremental foreign withholding or U.S. federal and state taxes should they either be deemed to be or are actually remitted to the United States, or if tax laws change, in which case our financial results could be adversely affected. In addition, recent proposals would make significant changes to U.S. taxation of U.S.-based multinational corporations. Although we cannot predict whether or in what form Congress would enact any such proposals, legislation of this type could have an adverse impact on our effective tax rate and financial results.

OUR RESULTS MAY BE HARMED BY THE WORLDWIDE ECONOMIC DOWNTURN

Since fiscal year 2008, the global economy has experienced a severe downturn due to the sequential effects of the subprime lending crisis, the credit market crisis, collateral effects on the finance and banking industries, volatile currency exchange rates and energy costs, concerns about inflation, slower economic activity, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns. These economic conditions worsened in fiscal year 2009. These conditions have shrunk capital equipment budgets, slowed decision-making, made financing for large equipment purchases more expensive and more time consuming, and made it difficult for our customers and our vendors to accurately forecast and plan future business activities. This, in turn, has caused and may continue to cause our customers to freeze or dramatically reduce purchases and capital project expenditures, and may result in consolidation of our customers. It may take time for our customers to establish new budgets and return to normal purchasing patterns once the economy improves. These conditions may also disrupt supply if vendors consolidate or go out of business. In such a climate, it has become and may continue to be more difficult for us to accurately forecast and plan our future business activities. We cannot predict when an economic recovery will occur, in general or specifically in the healthcare industry. Historically, our business has felt the effects of market trends later than other sectors in the healthcare industry, such as diagnostic radiology, and it is possible that we may experience the effects of any economic recovery later than others in the healthcare industry. A weak or deteriorating healthcare market would inevitably adversely affect our business, financial conditions and results of operations.

HEALTHCARE REFORM LEGISLATION MAY AFFECT DEMAND FOR OUR PRODUCTS AND COULD ADVERSELY AFFECT OUR REVENUE AND FINANCIAL CONDITION

Healthcare costs have risen significantly over the past decade. There have been and continue to be proposals by legislators, regulators and third-party payors to keep these costs down. Certain proposals, if passed, may impose limitations on the amounts of reimbursement available for our products from governmental agencies or third-party payors, or additional taxes on medical devices. These proposals could have a negative impact on the demand for our products and services, and therefore on our financial position and results of operations.

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Recently, President Obama and members of Congress have proposed significant reforms to the U.S. healthcare system. Both the U.S. Senate and House of Representatives have conducted hearings about U.S. healthcare reform. In the Obama administration s fiscal year 2010 federal budget proposal, the administration emphasized maintaining patient choice, reducing inefficiencies and costs, increasing prevention programs, increasing coverage portability and universality, improving quality of care and maintaining fiscal sustainability. The Obama administration s fiscal year 2010 budget included proposals to limit Medicare payments, reduce drug spending and increase taxes. In addition, members of Congress have proposed a significant tax on certain medical devices, a single-payer healthcare system, a government health insurance option to compete with private plans, and other expanded public healthcare measures. Various healthcare reform proposals have also emerged at the state level. We believe that the current uncertainty created by the prospects of healthcare reform in the United States has complicated our customers decision-making process and impacted our Oncology Systems business, and we expect that this uncertainty will persist until there is greater clarity on healthcare reform. We are unable to predict what healthcare reform legislation or regulations, if any, will be enacted in the United States or elsewhere; whether other healthcare legislation or regulations affecting our business may be proposed or enacted in the future; what effect any such legislation or regulation would have on our business; or the effect ongoing uncertainty surrounding these matters will have on our customer s purchasing decisions. However, an expansion in government s role in the U.S. healthcare industry may lower reimbursements for our products, reduce medical procedure volumes, and adversely affect our business, possibly materially.

CHANGES TO RADIATION ONCOLOGY REIMBURSEMENTS MAY AFFECT DEMAND FOR OUR PRODUCTS

Sales of our healthcare products indirectly depend on whether adequate reimbursement is available to our customers from a variety of sources, such as government healthcare insurance programs, including the Medicare and Medicaid programs; private insurance plans; health maintenance organizations and preferred provider organizations. Once Medicare has made a decision to provide reimbursement for a given treatment, these reimbursement rates are generally reviewed and adjusted by Medicare annually. Private third-party payors, although independent from Medicare, sometimes use portions of Medicare reimbursement policies and payment amounts in making their own reimbursement decisions. As a result, decisions by the U.S. Centers for Medicare and Medicaid Services (CMS) to reimburse for a treatment, or changes to Medicare s reimbursement policies or reductions in payment amounts with respect to a treatment sometimes extend to third-party payor reimbursement policies and amounts for that treatment. We have seen our customers decision-making process complicated by the uncertainty surrounding the recent proposed reduction in Medicare reimbursement rates for radiotherapy and radiosurgery at free-standing clinics in the United States and for physician reimbursement for radiation oncology. While the final enacted reimbursement rate reductions for 2010, which were announced by CMS on October 30, 2009, were much more modest for radiotherapy than originally proposed, we believe that the confusion and uncertainty created by the proposal has been a major factor impacting our net orders since mid-2009, particularly from free-standing radiotherapy clinics. From time to time, CMS and third party payors may review and modify the factors upon which they rely to determine appropriate levels of reimbursement for cancer treatments. For example, CMS and third-party payors have begun to focus on the comparative effectiveness of radiation therapy versus other methods of cancer treatment, and could modify reimbursement rates based on the results of comparative effectiveness studies. If adequate studies about the comparative effectiveness of radiotherapy are not available, or do not satisfactorily show how effective radiotherapy is versus other methods of cancer treatment, reimbursement rates for radiotherapy could be adversely affected. Any significant cuts in reimbursement rates for radiotherapy, radiosurgery, proton therapy or brachytherapy, or concerns or proposals regarding further cuts, could further increase uncertainty, influence our customers decisions, reduce demand for our products, cause customers to cancel orders and have a material adverse effect on our revenues and stock price.

In general, third-party payors are increasingly cost-conscious, and we cannot be sure that they will reimburse our customers at levels sufficient to enable us to achieve or maintain sales and price levels for our products. Without adequate support from third-party payors, the market for our products may be limited. There is no uniform policy on reimbursement among third-party payors, nor can we be sure that procedures using our products will qualify for reimbursement from third-party payors. Likewise, foreign governments also have their own healthcare reimbursement systems and we cannot be sure that adequate reimbursement will be made available with respect to our products under any foreign reimbursement system.

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OUR RESULTS MAY BE IMPACTED BY CHANGES IN FOREIGN CURRENCY EXCHANGE RATES

Because our business is global and payments are generally made in local currency, fluctuations in foreign currency exchange rates can impact our results by affecting product demand or our expenses and/or the profitability in U.S. dollars of products and services that we provide in foreign markets. We manage this risk through established policies and procedures that include the use of derivative financial instruments. We have historically entered into foreign currency forward exchange contracts, generally ranging from one to twelve months in maturity, to mitigate the effects of operational and balance sheet exposures to fluctuations in foreign currency exchange rates.

Although hedging strategies help to offset the effect of fluctuations in foreign currency exchange rates, the protection these strategies provide will be affected by the timing of transactions, and the effectiveness of those strategies, the number of transactions that are hedged, forecast volatility and the extent to which exchange rates have changed. In particular, foreign currency exchange rates have been extremely volatile over short periods of time since the beginning of 2008. If our hedging strategies do not offset these fluctuations, our revenues and other operating results may be harmed. In addition, movement in foreign currency exchange rates could impact our financial results positively or negatively in one period and not another, making it more difficult to compare our financial results from period to period.

In addition, long-term movements in foreign currency exchange rates can also affect the competitiveness of our products in the local currencies of our international customers. Even though our international sales are mostly in local currencies, our cost structure is weighted towards the U.S. dollar, and some of our competitors may have cost structures based in other currencies. The volatility of the U.S. dollar that we have experienced over the last several years has affected the competitiveness of our pricing against our foreign competitors, either helping or hindering our international order and revenue growth, thereby affecting our overall financial performance and results. Changes in monetary or other policies here and abroad, including as a result of the current economic downturn or in reaction thereto, or in the United States as a result of a change in the U.S. laws or regulations that will likely affect foreign currency exchange rates.

WE FACE SIGNIFICANT COSTS IN ORDER TO COMPLY WITH LAWS AND REGULATIONS APPLICABLE TO THE MANUFACTURE AND DISTRIBUTION OF OUR PRODUCTS, AND FAILURE OR DELAYS IN OBTAINING REGULATORY CLEARANCES OR APPROVALS, OR FAILURE TO COMPLY WITH APPLICABLE LAWS AND REGULATIONS COULD PREVENT US FROM DISTRIBUTING OUR PRODUCTS OR RESULT IN SIGNIFICANT PENALTIES

Our products and those of OEMs that incorporate our products are subject to extensive and rigorous government regulation, both in the United States and in foreign countries. Compliance with these laws and regulations is expensive and time-consuming, and failure to comply with these laws and regulations could adversely affect our business.

Marketing a medical device in the United States. In the United States, as a manufacturer and seller of medical devices and devices emitting radiation or utilizing radioactive by-product material, we and some of our suppliers and distributors are subject to extensive regulation by federal governmental authorities, such as the FDA, Nuclear Regulatory Commisson (NRC) and state and local regulatory agencies, such as the State of California, to ensure the devices are safe and effective and comply with laws governing products which emit, produce or control radiation. Similar international regulations apply overseas. These regulations govern, among other things, the design, development, testing, manufacturing, packaging, labeling, distribution, import/export, sale and marketing and disposal of our products.

Unless an exception applies, the FDA requires that the manufacturer of a new medical device or a new indication for use of, or other significant change in, an existing medical device obtain either 510(k) pre-market notification clearance or pre-market approval (PMA) before we can market or sell those products in the United States. Modifications or enhancements to a product that could significantly affect its safety or effectiveness, or that would constitute a major change in the intended use of the device, technology, materials, labeling, packaging, or manufacturing process may also require a new 510(k) clearance. Obtaining clearances or approvals is time-consuming, expensive and uncertain. We may not be able to obtain the necessary clearances or approvals or may be unduly delayed in doing so, which could harm our business. Furthermore, even if we are granted regulatory clearances or approvals, they may include significant limitations on the indicated uses of the product, which may limit the market for those products. If we were unable to obtain required FDA clearance or approval for a product or unduly delayed in doing so, or the uses of that product were limited, our business would suffer. In the past, in the United States, our devices have generally been subject to 510(k) clearance or exempt from 510(k) clearance. The 510(k) clearance process is generally less time-consuming, expensive and uncertain than the PMA process. However, there are some in the regulatory field who believe that certain medical devices should be required to use the PMA approval process rather than the 510(k) clearance process. If we were required to use the PMA approval process for future products or product modifications, it could delay or prevent release of the proposed products or modifications, which could harm our business.

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Marketing a medical device internationally. In order for us to market our products internationally, we must obtain clearances or approvals for products and product modifications. These processes (including for example in the EEA, China, Japan and Canada) can be time consuming, expensive, and uncertain, which can delay our ability to market products in those countries. If we do not obtain the clearance or approvals on one or more of our products, or are unduly delayed in doing so, or if a clearance or approval includes significant limitations on the indicated uses of the product, the market for the affected products would be negatively impacted.

Within the EEA, we must receive a CE mark, a European marking of conformity that indicates that a product meets the relevant regulatory requirements and, when used as intended, works properly and is acceptably safe. This conformity to the applicable directives is done through self-declaration and is verified by an independent certification body, called a Notified Body, before the CE mark can be granted. Once clearance is obtained and the CE mark is affixed to the device, the Notified Body will regularly audit us to ensure that we remain in compliance with the applicable European laws or directives. CE marking demonstrates that our products comply with the laws and regulations required by the EEA countries to allow free movement of trade within the EEA countries. If we cannot support our performance claims and demonstrate compliance with the applicable European laws and directives, we lose our CE mark, which would prevent us from selling our products within the EEA.

Quality systems, audits and failure to comply. Our manufacturing operations are required to comply with the FDA s QSR, and other federal and state regulations for medical devices and radiation emitting products that address a company s responsibility for complying with the quality systems regulations, which include the requirements for current good manufacturing practices. The FDA makes announced and unannounced inspections of medical device manufacturers to determine compliance with QSR and in connection with these inspections has issued, and in the future may issue, reports, known as Form FDA 483 reports (listing instances where the manufacturer has failed to comply with applicable regulations and/or procedures), or Warning Letters citing failure to comply with applicable regulations or procedures. If a Warning Letter were issued, we would be required to take prompt corrective action to come into compliance. Failure to respond timely to a Warning Letter or other notice of noncompliance and to come into compliance could result in the FDA bringing enforcement action against us, which could include the total shutdown of our production facilities and criminal and civil fines. Additionally, if a Warning Letter were issued, customers could delay purchasing decisions or cancel orders, and we could face increased pressure from our competitors, who could use the Warning Letter against us in competitive sales situations, either of which could adversely affect our reputation, business and stock price.

In addition, we are required to timely file various reports with the FDA and other international regulatory authorities, including reports required by the medical device reporting regulations, and similar international adverse event reporting regulations, that require that we report to regulatory authorities if our devices may have caused or contributed to a death or serious injury or malfunctioned in a way that would likely cause or contribute to a death or serious injury if the malfunction were to recur. If these reports are not filed timely, regulators may impose sanctions and sales of our products may suffer, and we may be subject to product liability or regulatory enforcement actions, all of which could harm our business.

If we initiate a correction or removal of a device to reduce a risk to health posed by the device, we would be required to submit a Corrections and Removals report to the FDA and in many cases, similar reports to other regulatory agencies. This report could be classified by the FDA as a device recall which could lead to increased scrutiny by the FDA and other international regulatory agencies regarding the quality and safety of our devices.

Our medical devices utilizing radioactive material are subject to the NRC clearance and approval requirements, and the manufacture and sale of these products are subject to extensive international, federal and state regulation that varies from state to state and among countries or regions. Our manufacture, distribution, installation and service of medical devices utilizing radioactive material or emitting radiation also requires us to obtain a number of licenses and certifications for these devices and materials. Service of these products must also be in accordance with a specific radioactive materials license. In addition, we are subject to a variety of environmental laws regulating our manufacturing operations and the handling, storage, transport and disposal of hazardous materials, and which impose liability for the cleanup of any contamination from these materials. In particular, the handling and disposal of radioactive materials resulting from the manufacture, use or disposal of our products may impose significant costs and requirements. Disposal sites for the lawful disposal of materials generated by the manufacture, use or decommissioning of our products may no longer accept these materials in the future, or may accept them on unfavorable terms.

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The FDA and the Federal Trade Commission (FTC) also regulate advertising and promotion of our products to ensure that the claims we make are consistent with our regulatory clearances, that there are scientific data to substantiate the claims and that our advertising is neither false nor misleading. If the FDA or FTC determines that any of our advertising or promotional claims are not permissible, we may be subject to enforcement actions and may be required to revise our promotional claims or make other corrections or restitutions.

If we or any of our suppliers, distributors or customers fail to comply with FDA, FTC and other applicable U.S. and foreign country regulatory requirements or are perceived to potentially have failed to comply, we may face:

- adverse publicity affecting both us and our customers;
- increased pressures from our competitors;
- investigations by governmental authorities or Warning Letters;
- fines, injunctions, and civil penalties;
- partial suspensions or total shutdown of production facilities, or the imposition of operating restrictions;
- increased difficulty in obtaining required FDA clearances or approvals, or the equivalent approvals in foreign countries;
- losses of clearances or approvals already granted;
- seizures or recalls of our products or those of our customers;
- delays in purchasing decisions by customers or cancellation of existing orders;
- the inability to sell our products, or, where we have failed to comply with foreign regulations, to import our products to such countries; and
- criminal prosecutions.

Other applicable regulations. As a participant in the healthcare industry, we are also subject to extensive laws and regulations protecting the privacy and integrity of patient medical information, including the Health Insurance Portability and Accountability Act of 1966 (HIPAA) and similar laws and regulations in foreign countries covering data privacy and other protection of health and employee information, fraud and abuse laws and regulations, including, physician self-referral prohibitions, anti-kickback laws and false claims laws. From time to time, these laws and regulations may be revised or interpreted in ways that could make it more difficult for our customers to conduct their businesses, such as recent proposed revisions to the laws prohibiting physician self-referrals, and such revisions could have an adverse effect on the demand for our products, and therefore our business and results of operations. We also must comply with numerous federal, state and local laws of more general applicability relating to such matters as safe working conditions, manufacturing practices and fire hazard control.

The laws and regulations and their enforcement are constantly undergoing change, and we cannot predict what effect, if any, changes to these laws and regulations may have on our business. There has been a trend in recent years, both in the United States and internationally, toward

more stringent regulation and enforcement of requirements applicable to medical device manufacturers and requirements regarding protection and confidentiality of personal data.

Government regulation also may cause considerable delay or even prevent the marketing and full commercialization of future products or services that we may develop, and/or may impose costly requirements on our business. Insurance coverage is not commercially available for violations of law, including the fines, penalties or investigatory costs that may flow to us as the consequence of regulatory violations; consequently, we do not have insurance that would cover this type of liability.

COMPLIANCE WITH FOREIGN LAWS AND REGULATIONS APPLICABLE TO THE MANUFACTURE AND DISTRIBUTION OF OUR PRODUCTS MAY BE COSTLY, AND FAILURE TO COMPLY MAY RESULT IN PENALTIES

Regulatory requirements affecting our operations and sales outside the United States vary from country to country, often differing significantly from those in the United States. In general, outside the United States, our products are regulated as medical devices by foreign governmental agencies similar to the FDA. We are also subject to laws and regulations that apply to manufacturers of radiation emitting devices and products utilizing radioactive materials, as well as laws and regulations of

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general applicability relating to matters such as environmental protection, safe working conditions, manufacturing practices and other matters. These are often comparable to, if not more stringent than, the equivalent regulations in the United States. Sales overseas are also affected by regulation of matters such as product standards, packaging, labeling, environmental and product recycling requirements, import and export restrictions, tariffs, duties and taxes. In some countries, we rely on our foreign distributors to assist us in complying with foreign regulatory requirements, and we cannot be sure that they will always do so. We may be required to incur significant time and expense in obtaining and maintaining regulatory approvals. Delays in receipt of or failure to receive regulatory approvals, the loss of previously obtained approvals or failure to comply with existing or future regulatory requirements could restrict or prevent us from doing business in a country or subject us to a variety of enforcement actions and civil or criminal penalties, which would adversely affect our business.

WE ARE SUBJECT TO FEDERAL, STATE AND FOREIGN LAWS GOVERNING OUR BUSINESS PRACTICES WHICH, IF VIOLATED, COULD RESULT IN SUBSTANTIAL PENALTIES. ADDITIONALLY, CHALLENGES TO OR INVESTIGATION INTO OUR PRACTICES COULD CAUSE ADVERSE PUBLICITY AND BE COSTLY TO RESPOND TO AND THUS COULD HARM OUR BUSINESS

The Medicare and Medicaid anti-kickback laws, and several similar state laws, prohibit payments or other remuneration that is intended to induce hospitals, physicians or others either to refer patients or to purchase, lease or order, or arrange for or recommend the purchase, lease or order of healthcare products or services for which payment may be made under federal and state healthcare programs, such as Medicare and Medicaid. These laws affect our sales, marketing and other promotional activities by limiting the kinds of financial arrangements we may have with hospitals, physicians or other potential purchasers of our products. They particularly impact how we structure our sales offerings, including discount practices, customer support, education and training programs, physician consulting, research grants and other service arrangements. These laws are broadly written, and it is often difficult to determine precisely how these laws will be applied to specific circumstances.

Federal and state false claims laws generally prohibit knowingly presenting, or causing to be presented, claims for payment from Medicare, Medicaid or other third-party payors that are false or fraudulent, or for items or services that were not provided as claimed. Although we do not submit claims directly to payors, manufacturers can be held liable under these laws if they are deemed to cause the submission of false or fraudulent claims by providing inaccurate billing or coding information to customers, or through certain other activities, including promoting products for uses not approved or cleared by the FDA, which is called off-label promotion. Violating anti-kickback and false claims laws can result in civil and criminal penalties, which can be substantial, and potential exclusion from healthcare programs for noncompliance. Even an unsuccessful challenge or investigation into our practices could cause adverse publicity, and be costly to defend, and thus could harm our business and results of operations. Additionally, several proposals and bills are being considered at both the state and federal levels expanding anti-kickback laws to require, among other things, extensive tracking, maintenance of data bases regarding and disclosures of relationships and payments to physicians and healthcare providers. If these proposals or bills were to become law, the implementation of the necessary infrastructure to comply with them could be quite costly.

We are subject to similar laws in foreign countries where we conduct business. For example, within the European Union (EU), the control of unlawful marketing activities is a matter of national law in each of the member states of the EU. The member states of the EU closely monitor perceived unlawful marketing activity by companies. We could face civil, criminal and administrative sanctions if any member state determines that we have breached our obligations under its national laws. Industry associations also closely monitor the activities of member companies. If these organizations or authorities name us as having breached our obligations under their regulations, rules or standards, our reputation would suffer and our business and financial condition could be adversely affected.

We are also subject to the U.S. Foreign Corrupt Practices Act, antitrust and anti-competition laws, and similar laws in foreign countries, any violation of which could create a substantial liability for us and also cause a loss of reputation in the market. From time to time, we may face audits or investigations by one or more domestic or foreign government agencies, compliance with which could be costly and time-consuming, and could divert our management and key personnel from our business operations. An adverse outcome under any such investigation or audit could subject us to fines or other penalties, which could adversely affect our business and financial results.

As we enter new businesses or pursue new business opportunities, we may become subject to laws, rules and regulations, such as FDA regulations applicable to clinical trials. Becoming familiar with and implementing the infrastructure necessary to comply with these laws, rules and regulations could be quite costly. In addition, failure to comply with these laws, rules and regulations could delay the introduction of new products and could adversely affect our business.

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PRODUCT DEFECTS OR MISUSE MAY RESULT IN MATERIAL PRODUCT LIABILITY OR PROFESSIONAL ERRORS AND OMISSIONS CLAIMS, INVESTIGATION BY REGULATORY AUTHORITIES OR PRODUCT RECALLS THAT COULD HARM FUTURE REVENUES AND REQUIRE US TO PAY MATERIAL UNINSURED CLAIMS

Our business exposes us to potential product liability claims that are inherent in the manufacture, sale, installation, servicing and support of medical devices and other devices that deliver radiation. Because our products are involved in the intentional delivery of radiation to the human body, other situations where people may come in contact with radiation (for example, when our SIP products are being used to scan cargo), the collection and storage of patient treatment data for medical analysis and treatment delivery, the planning of radiation treatment and diagnostic imaging of the human body, and the diagnosing of medical problems, the possibility for significant injury and/or death exists. Our medical products operate within our customers facilities and network systems, and under quality assurance procedures established by the facility that ultimately result in the delivery of radiation to patients. Human and other errors or accidents may arise from the fact that our products operate in complex environments with products from other vendors, where interoperability or data sharing protocol may not be optimized even though the equipment or system operate according to specifications. As a result, we may face substantial liability to patients, our customers and others for damages resulting from the faulty, or allegedly faulty, design, manufacture, installation, servicing, support, testing or interoperability of our products, or their misuse or failure, as well as liability related to the loss or misuse of private patient data. We may also be subject to claims for property damages or economic loss related to or resulting from any errors or defects in our products, or installation, servicing and support of our products. With any accident or mistreatment, we could be subject to legal costs, adverse publicity and damage to our reputation, whether or not our products or services were a factor. Adverse publicity could adversely impact our business by negatively affecting the reputation of radiation therapy in general, causing patients to question the efficacy of radiation therapy as a viable treatment for cancer and seek other methods of treatment. In addition, publicity regarding any accidents or mistreatments could cause patients to be less receptive to radiotherapy treatments or result in additional regulation of radiation therapy, medical devices or the healthcare industry in general. Increased regulatory activities could adversely affect our ability to promote, manufacture and sell our products, and therefore negatively impact our business and results of operations.

In addition, if a product we designed or manufactured were defective (whether due to design, labeling or manufacturing defects, improper use of the product or other reasons), we may be required to recall the product and notify regulatory authorities. The adverse publicity resulting from a recall could damage our reputation and cause customers to review and potentially terminate their relationships with us. A product recall could consume management time and have an adverse financial impact on our business, including incurring substantial costs, lost revenues and loss accruals under GAAP that may cause our quarterly results to fluctuate.

We maintain limited product liability insurance coverage and currently self-insure professional liability/errors and omissions liability. The product liability insurance policies that we maintain are expensive and have high deductible amounts and self-insured retentions. The insurance coverage we have obtained may prove to be inadequate, and future policies may not be available on acceptable terms or in sufficient amounts, if at all. A material claim successfully brought against us relating to a self-insured liability or a liability that is in excess of our insurance coverage, or for which insurance coverage is denied or limited would require us to pay damage amounts that could be substantial and have a material adverse effect on our financial position and results of operation.

WE COMPETE IN HIGHLY COMPETITIVE MARKETS, AND WE MAY LOSE MARKET SHARE TO COMPANIES WITH GREATER RESOURCES OR THE ABILITY TO DEVELOP MORE EFFECTIVE TECHNOLOGIES, OR WE COULD BE FORCED TO REDUCE OUR PRICES

Rapidly evolving technology, intense competition and pricing pressure characterize the markets for radiation therapy equipment and software. Some of our competitors have greater financial, marketing and other resources than we have. Also, we believe that new competitors will enter our markets, as we have encountered new competitors as we enter new markets such as stereotactic radiosurgery, VMAT and proton therapy. To compete successfully, we must provide technically superior, clinically proven products that deliver more precise, cost-effective, high quality clinical outcomes, together in a complete package of products and services, and to do so ahead of our competitors. As our Oncology Systems products are generally sold on a basis of total value to the customer, our business may suffer when purchase decisions are based solely upon price, which can if hospitals and clinics give purchasing decision authority to group purchasing organizations. In addition, additional competitors may delay customer purchasing decisions as customers evaluate the products of these competitors along with ours, potentially extending our sales cycle and adversely affect our net orders. In the radiotherapy and

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radiosurgery markets, we compete primarily with Elekta AB, Siemens Medical Solutions, Tomotherapy Incorporated and Accuray Incorporated. With our information and image management, simulation, treatment planning and radiosurgery products, we also compete with a variety of companies, such as Elekta, Philips Medical Systems, Best Theratronics, Ltd., Nucletron B.V. and Siemens Medical Solutions. We also encounter some competition from providers of hospital information systems. In our brachytherapy operations, our primary competitor is Nucletron B.V. For the service and maintenance business for our Oncology Systems products, we compete with independent service organizations and our customers internal service organizations.

In x-ray imaging components and subsystems, we often compete with companies that have greater financial, marketing and other resources than we have. Some of the major diagnostic imaging systems companies, which are the primary OEM customers for our x-ray components, also manufacture x-ray components for use in their own imaging systems products. We must compete with these in-house manufacturing operations for business from their affiliated companies. As a result, we must have a competitive advantage in one or more significant areas, which may include lower product cost, better product quality and/or superior technology and/or performance. We sell a significant volume of our x-ray tubes to OEMs such as Toshiba Corporation, Hitachi Medical Corporation, Philips Medical Systems and GE Healthcare, all of which have in-house x-ray tube production capability. In addition, we compete against other stand-alone, independent x-ray tube manufacturers such as Comet AG and IAE Industria Applicazioni Elettroniche Spa. These companies compete with us for both the OEM business of major diagnostic imaging equipment manufacturers and the independent servicing business for x-ray tubes. The market for flat panel detectors is also very competitive and we primarily compete against Perkin-Elmer, Inc., Trixell S.A.S., and Canon, Inc. in our flat panel detector product line.

In our SIP business, we compete with other OEM suppliers, primarily outside of the United States, and our major competitor in this market is Nuctech Company Limited. The market for our SIP products used for nondestructive testing in industrial applications is small and highly fractured, and there is no single major competitor.

The market for proton therapy products is still developing and is characterized by rapidly evolving technology, high competition and pricing pressure. Our ability to compete successfully depends, in part, on our ability to complete the development of our commercial proton therapy system, lower our product costs, develop and provide technically superior, clinically proven products that deliver more precise, cost-effective, high quality clinical outcomes, including integration of IGRT technologies such as OBI. In the proton therapy market, we compete principally with Ion Beam Applications S.A.

In each of our business segments, existing competitors actions and new entrants may adversely affect our ability to compete. These competitors could develop technologies and products that are more effective than those we currently use or produce or that could render our products obsolete or noncompetitive. In addition, the timing of our competitors introduction of products into the market could affect the market acceptance and market share of our products. Some competitors offer specialized products that provide, or may be perceived by customers to provide, a marketing advantage over our mainstream cancer treatment products. Also, some of our competitors may not be subject to the same standards, regulatory and/or other legal requirements that we are, and therefore, they could have a competitive advantage in developing, manufacturing and marketing products and services. Any inability to develop, gain regulatory approval for and supply commercial quantities of competitive products to the market as quickly and effectively as our competitors could limit market acceptance of our products and reduce our sales. In addition, some of our smaller competitors could be acquired by larger companies that have greater financial strength, which could enable them to compete more aggressively. Our competitors could also acquire some of our suppliers or distributors, which could disrupt these supply or distribution arrangements and result in less predictable and reduced revenues in our businesses. Any of these competitive factors could negatively affect our pricing, sales, revenues, market share and gross margins and our ability to maintain or increase our operating margins.

OPEN ARCHITECTURE IS BECOMING INCREASINGLY IMPORTANT, AND SALES OF OUR PRODUCTS COULD FALL IF WE FAIL TO ACHIEVE THIS

As radiation therapy becomes more and more complex, interoperability and compatibility of the various products used in treating patients becomes more important. Our linear accelerators, treatment simulators, treatment verification products, treatment planning and information management software products are designed to interoperate with one another, and, wherever possible, to use standard published protocols for communication with other widely used radiation oncology products manufactured by other companies. In the event proper communication with particular third party products cannot be achieved using standard published protocols, we may need to develop individual interfaces so that our products communicate correctly. Obtaining and maintaining this interoperability and compatibility can be costly and time-consuming. When other companies modify the design or functionality of their products, this may affect their compatibility with our products. When we implement design improvements to our products, customers may be reluctant to adopt our new technology due to

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interoperability issues. For example, a clinic may be unwilling to implement one of our new technologies because its third-party software does not yet communicate correctly with our new product. Our ability to obtain compatibility with products of other companies may depend on our ability to obtain adequate information from them regarding their products. In many cases, these third parties are our competitors and may schedule their product changes and delay their release of relevant information to us to place us at a competitive disadvantage. When we modify our products to make them interoperable or compatible with third-party products, we may be required to obtain additional regulatory clearances. This process is costly and could result in delay in our ability to release our products for commercial use. It is also possible that, despite our best efforts, we may not be able to make our products interoperable or compatible with widely used third-party products or may only be able to do so at a prohibitive expense, making our products less attractive or more costly to our customers.

PROTECTING OUR INTELLECTUAL PROPERTY CAN BE COSTLY, AND OUR COMPETITIVE POSITION WOULD BE HARMED IF WE ARE NOT ABLE TO DO SO

We file applications as appropriate for patents covering new products and manufacturing processes. We cannot be sure, however, that our current patents, the claims allowed under our current patents, or patents for technologies licensed to us will be sufficiently broad to protect our technology position against competitors. Issued patents owned by, or licensed to, us may be challenged, invalidated or circumvented, or the rights granted under the patents may not provide us with competitive advantages. We also cannot be sure that patents will be issued from any of our pending or future patent applications. Asserting our patent rights against others in litigation or other legal proceedings is costly and diverts managerial resources. An unfavorable outcome in any such litigation or proceeding could harm us. In addition, we may not be able to detect patent infringement by others or may lose our competitive position in the market before we are able to do so.

We also rely on a combination of copyright, trade secret and other laws, and contractual restrictions on disclosure, copying and transferring title (including confidentiality agreements with vendors, strategic partners, co-developers, employees, consultants and other third parties), to protect our proprietary rights. These protections may prove inadequate, since agreements may still be breached and we may not have adequate remedies for a breach, and our trade secrets may otherwise become known to or be independently developed by others. We have trademarks, both registered and unregistered, that are maintained and enforced to provide customer recognition for our products in the marketplace, but unauthorized third parties may still use them. We also have agreements with third parties that license to us certain patented or proprietary technologies. If we were to lose the rights to license these technologies, or our costs to license these technologies were to materially increase, our business would suffer.

THIRD PARTIES MAY CLAIM WE ARE INFRINGING THEIR INTELLECTUAL PROPERTY, AND WE COULD SUFFER SIGNIFICANT LITIGATION OR LICENSING EXPENSES OR BE PREVENTED FROM SELLING OUR PRODUCTS

The industries in which we compete are characterized by a substantial amount of litigation over patent and other intellectual property rights. Our competitors, like companies in many high technology businesses, continually review other companies products for possible conflicts with their own intellectual property rights. Determining whether a product infringes a third party s intellectual property rights involves complex legal and factual issues, and the outcome of this type of litigation is often uncertain. Third parties may claim that we are infringing their intellectual property rights, and we may be found to infringe those intellectual property rights. We may not be aware of intellectual property rights of others that relate to our products, services or technologies. From time to time, we have received notices from third parties asserting infringement and we have been subject to lawsuits alleging infringement of third-party patent or other intellectual property rights. Any dispute regarding patents or other intellectual property could be costly and time-consuming, and could divert our management and key personnel from our business operations, and we may not prevail in a dispute. We do not maintain insurance for intellectual property infringement, so if we are unsuccessful in defending an infringement claim, we may be subject to significant damages or injunctions against development and sale of our products, or may be required to enter into costly royalty or license agreements. Required licenses may not be made available to us on acceptable terms or at all.

THE LOSS OF A SUPPLIER OR ANY INABILITY TO OBTAIN SUPPLIES OF IMPORTANT COMPONENTS COULD RESTRICT OUR ABILITY TO MANUFACTURE PRODUCTS, CAUSE DELAYS IN OUR ABILITY TO DELIVER PRODUCTS, OR SIGNIFICANTLY INCREASE OUR COSTS

We obtain some of the components included in our products from a limited group of suppliers or from a single-source supplier, such as the radioactive sources for high-dose afterloaders, klystrons for linear accelerators, array sensors for use in our imaging panels, cesium iodide coatings for the arrays, and specialized integrated circuits, x-ray tube targets, housings, glassframes and various other x-ray tube components. If we lose any of these suppliers or if their operations were

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substantially interrupted, we would be required to obtain and qualify one or more replacement suppliers, which may then also require us to redesign or modify our products to incorporate new parts and/or further require us to obtain clearance, qualification or certification of such product by the FDA or other applicable regulatory approvals in other countries. Events like these could significantly increase costs for the affected product and likely cause material delays in delivery of that and other related products. We have limited insurance to protect against business interruption loss, although our coverage may not be adequate or continue to remain available on acceptable terms, if at all. Additionally, some of these suppliers, including our single-source suppliers, supply components for certain of our rapidly growing product lines. Manufacturing capacity limitations of any of these suppliers or other inability of these suppliers to meet increasing demand could adversely affect us, resulting in curtailed growth opportunities for any of our product lines. Shortage of, and greater demand for, components and subassemblies could also increase manufacturing costs by increasing prices. Disruptions or loss of any of our limited- or sole-source components or subassemblies or the capacity limitations of the suppliers for these components or subassemblies, including the ones referenced above, could adversely affect our business and financial results and could damage our customer relationships.

A SHORTAGE OF RAW MATERIALS COULD RESTRICT OUR ABILITY TO MANUFACTURE PRODUCTS, CAUSE DELAYS, OR SIGNIFICANTLY INCREASE OUR COST OF GOODS

We rely upon the supplies of certain raw materials such as tungsten, lead and copper for Oncology Systems and SIP; copper, lead, tungsten, rhenium, molybdenum zirconium, and various high grades of steel alloy for X-ray Products, and high-grade steel and high-grade copper for the Varian Particle Therapy business. Demand for these raw materials both within the United States and from foreign countries, such as China, has increased over the last few years, resulting in limited supplies and higher prices. Worldwide demand, availability and pricing of these raw materials have been volatile, and we expect that availability and pricing will continue to fluctuate in the future. If supplies are restricted and prices increase, this could constrain our manufacturing of affected products, reduce our profit margins or otherwise adversely affect our business.

CONSOLIDATION AMONG OUR ONCOLOGY SYSTEMS CUSTOMERS COULD ADVERSELY AFFECT OUR SALES OF ONCOLOGY PRODUCTS

We have seen and may continue to see some consolidation among our customers in our Oncology Systems business, as hospitals and clinics combine through mergers and acquisitions, and as they join group purchasing organizations or affiliated enterprises. As customers consolidate, the volume of product sales to these customers might decrease. Alternatively, order size may increase as what were previously more than one customer combine orders as one entity. As a result, the purchasing cycle for our Oncology Systems products could lengthen, as orders increase in size and require more customer approvals. Both increased order size and extended purchasing cycles could cause our net orders for these products to be more volatile and less predictable. In addition, group purchasing organizations often focus on pricing as the determinant in making purchase decisions. A reduction in net orders could affect the level of future revenues, which would adversely affect our operating results, financial condition, and the price of VMS common stock.

WE SELL OUR X-RAY TUBES TO A LIMITED NUMBER OF OEM CUSTOMERS, MANY OF WHICH ARE ALSO OUR COMPETITORS, AND A REDUCTION IN BUSINESS BY ONE OR MORE OF THESE CUSTOMERS OR CONSOLIDATION OF CUSTOMERS COULD REDUCE OUR SALES

There has been a consolidation of diagnostic imaging systems manufacturers over the past few years, including the consolidation of these customers into companies that already manufacture x-ray tubes. If this continues, we could experience less predictable and reduced sales of our x-ray tube products. In addition, the general worldwide economic downturn we have seen since 2008 has made and may continue to make it difficult for our OEM customers to accurately forecast and plan future business activities, and we saw our x-ray business impacted in fiscal year 2009 by inventory reduction efforts at some of these customers. The market for new X-ray imaging equipment has been weak, and certain product lines, such as dental and veterinary, have been hit particularly hard in the recession. Continued or further deterioration in the markets for our customers products may adversely affect our X-ray Products business. In recent years, we have also seen dramatic reductions in Medicare reimbursements for diagnostic radiology. We believe reductions in these Medicare reimbursement rates have reduced demand for medical x-ray imaging equipment, such as CT scanners, which have negatively impacted demand for our x-ray tube products. Also, because we sell our x-ray products to a limited number of OEM customers and many of them are also our competitors with in-house x-ray tube manufacturing operations, we could experience the loss of, or reduction in purchasing volume by, one or more of these customers as they lower external sourcing costs in this economic downturn. Such a loss or reduction could have a material adverse effect on our X-ray Products business.

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ORDERS FOR OUR SECURITY AND INSPECTION PRODUCTS COULD BE UNPREDICTABLE

Our SIP business designs, manufactures, sells and services Linatron x-ray accelerators, imaging processing software and image detection products for security and inspection, such as cargo screening at ports and borders and nondestructive examination for a variety of applications. We generally sell SIP products to OEMs who incorporate our products into their inspection systems, which are then sold to customs and other government agencies, as well as to commercial organizations in the casting, power, aerospace, chemical, petro-chemical and automotive industries. We believe growth in the SIP business will be driven by security cargo screening and border protection needs, as well as by the needs of customs agencies to verify shipments for assessing duties and taxes. However, use of linear accelerator and imaging technology in security cargo screening and border protection is in its early stages. Orders for our SIP products have been and may continue to be unpredictable as governmental agencies may place large orders with us or our OEM customers in a short time period, and then may not place any orders for a long time period thereafter. Because it is difficult to predict our OEM customer delivery and acceptance schedules, the actual timing of sales and revenue recognition will vary significantly.

In addition, our SIP business is heavily influenced by U.S. and foreign governmental policies on national and homeland security, border protection and customs revenue activities, which depend upon government budgets and appropriations that are subject to political changes. We have seen customers freeze or dramatically reduce purchases and capital project expenditures, or act cautiously as governments around the world wrestle with spending priorities. As a result, this business is subject to unpredictability in the timing of orders, sales and revenue that could cause volatility in our revenues and earnings, and therefore the price of VMS common stock.

IF WE ARE UNABLE TO PROVIDE THE SIGNIFICANT EDUCATION AND TRAINING REQUIRED FOR THE HEALTHCARE MARKET TO ACCEPT OUR PRODUCTS, OUR BUSINESS WILL SUFFER

In order to achieve market acceptance for our radiation therapy products, we often need to educate physicians about the use of a new treatment procedure such as IMRT, IGRT, VMAT, stereotactic radiosurgery or proton therapy, overcome physician objections to some of the effects of the product or its related treatment regimen, convince healthcare payors that the benefits of the product and its related treatment process outweigh its costs and help train qualified physicists in the skilled use of our products. For example, the complexity and dynamic nature of IMRT and IGRT requires significant education of hospital personnel and physicians regarding the benefits of IMRT and IGRT and the required departures from their customary practices. Further, the complexity and high cost of proton therapy requires similar significant education, as well as education regarding construction and facility requirements. We have expended and will continue to expend significant resources on marketing and educational efforts to create awareness of IMRT, IGRT, VMAT, stereotactic radiosurgery and proton therapy generally and to encourage the acceptance and adoption of our products for these technologies. We cannot be sure that any products we develop will gain significant market acceptance among physicians, patients and healthcare payors, even if we spend significant time and expense on their education.

OUR BUSINESS MAY SUFFER IF WE ARE NOT ABLE TO HIRE AND RETAIN QUALIFIED PERSONNEL

Our future success depends, to a significant extent, on our ability to attract, expand, integrate, train and retain our management team, qualified engineering personnel, technical personnel and sales and marketing staff. We compete for key personnel with other medical equipment and software manufacturers and technology companies, as well as universities and research institutions. Because this competition is intense, costs related to compensation could increase significantly if supply decreases or demand increases. If we are unable to hire, train or retain qualified personnel, we will not be able to maintain and expand our business, and our business would suffer.

IF WE ARE NOT ABLE TO MATCH OUR MANUFACTURING CAPACITY WITH DEMAND FOR OUR PRODUCTS, OUR FINANCIAL RESULTS MAY SUFFER

Our products have a long production cycle and we need to anticipate demand for our products in order to ensure adequate manufacturing or testing capacity. If we are unable to anticipate demand and our manufacturing or testing capacity does not keep pace with product demand, we will not be able to fulfill orders timely, which may negatively impact our financial results and overall business. Conversely, if demand for our products decreases, the fixed costs associated with excess manufacturing capacity may harm our financial results.

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IF WE FAIL TO SUCCESSFULLY ACQUIRE OR INTEGRATE NEW BUSINESSES, PRODUCTS AND TECHNOLOGY, WE MAY NOT REALIZE EXPECTED BENEFITS OR MAY HARM OUR BUSINESS

We need to grow our businesses in response to changing technologies, customer demands and competitive pressures. In some circumstances, we may decide to grow our business through the acquisition of complementary businesses, products or technologies rather than through internal development. For example, in fiscal year 2009 we acquired certain assets of IKOE, a supplier of software used in the planning of radiotherapy and radiosurgery treatments. Identifying suitable acquisition candidates can be difficult, time-consuming and costly, and we may not be able to identify suitable candidates or successfully complete identified acquisitions. In addition, completing an acquisition can divert our management and key personnel from our business operations, which could harm our business and affect our financial results. Even if we complete an acquisition, we may not be able to successfully integrate newly acquired organizations, products, technologies or employees into our operations, or may not fully realize some of the expected synergies.

Integrating an acquisition can also be expensive and time-consuming, and may strain our resources. It may cost us more to commercialize new products than we originally anticipated, as we are experiencing with our proton therapy systems. These additional expenditures could be significant and could cause our results of operations to suffer. In many instances, integrating a new business will also involve implementing or improving internal controls appropriate for a public company at a business that lacks them. In addition, we may be unable to retain the employees of acquired companies, or the acquired company s customers, suppliers, distributors or other partners for a variety of reasons, including the fact that these entities may be our competitors or may have close relationships with our competitors.

Further, we may find that we need to restructure or divest acquired businesses, or assets of those businesses. Even with restructuring activities or divestitures, an acquisition may not produce the full efficiencies and benefits we expect. Consequently, we may not achieve anticipated growth or other benefits from an acquisition, which could harm our existing business. If we decide to sell assets or a business, as we did in fiscal year 2008 with Research Instruments, it may be difficult to identify buyers or alternative exit strategies on acceptable terms, in a timely manner, or at all, which could delay the accomplishment of our strategic objectives, or we may dispose of a business at a price or on terms that are less than we had anticipated.

We account for our acquisitions under the purchase method of accounting. Under this method, we allocate the total purchase price to the acquired businesses tangible assets and liabilities, identifiable intangible assets and in-process research and development costs based on their fair values as of the date of the acquisition, and record the excess of the purchase price over those fair values as goodwill. If we fail to achieve the anticipated growth from an acquisition, or if we decide to sell assets or a business, we may be required to recognize an impairment loss on the write down of our assets and goodwill, which could adversely affect our business and financial operations. In addition, acquisitions can result in potentially dilutive issuances of equity securities or the incurrence of debt, contingent liabilities or expenses, or other charges, any of which could harm our business and affect our financial results.

WE MAY FACE ADDITIONAL RISKS FROM THE ACQUISITION OR DEVELOPMENT OF NEW LINES OF BUSINESS

From time to time, we may acquire or develop new lines of business, such as proton therapy. There are substantial risks and uncertainties associated with this, particularly in instances where the markets are not fully developed. Risks include developing knowledge of and experience in the new business, recruiting market professionals, increasing research and development expenditures, and developing and capitalizing on new relationships with experienced market participants. This may mean significant investment and involvement of our senior management to acquire or develop, then integrate, the business into our operations. Timelines for integration of new businesses may not be achieved and price and profitability targets may not prove feasible, as new products can carry lower gross margins. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact whether implementation of a new business will be successful. Failure to manage these risks in the development and implementation of new businesses successfully could materially and adversely affect our business, results of operations and financial condition.

WE MAY NOT BE ABLE TO SUCCESSFULLY RESOLVE RESIDUAL ISSUES RELATED TO THE SALE OF OUR RESEARCH INSTRUMENTS BUSINESS

In the second quarter of fiscal year 2009, we completed the sale the Research Instruments business, but retained responsibility for certain contracts. We may incur additional costs beyond those expected with these remaining obligations

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which could adversely affect our financial condition. Continued efforts related to managing these remaining obligations may require a substantial amount of management, administrative and operational resources, particularly if unanticipated difficulties with the fulfillment of these contracts are encountered. These demands may distract our employees and management from the day-to-day operation of our other businesses.

WE WORK WITH DISTRIBUTORS FOR SALES IN SOME TERRITORIES, AND LOSING THEM COULD HARM OUR REVENUES IN THAT TERRITORY

We have strategic relationships with a number of key distributors for sales and service of our products, principally in Europe and Asia. If these strategic relationships end and are not replaced, our revenues and/or ability to service our products in the territories serviced by these distributors could be adversely affected.

FLUCTUATIONS IN OUR OPERATING RESULTS, INCLUDING QUARTERLY NET ORDERS, REVENUES, AND GROSS MARGINS, MAY CAUSE OUR STOCK PRICE TO BE VOLATILE, WHICH COULD CAUSE LOSSES FOR OUR STOCKHOLDERS

We have experienced and expect in the future to experience fluctuations in our operating results, including net orders, revenues and gross margins. Many of our products require significant capital expenditures by our customers. Accordingly, individual product orders can be quite large in dollar amounts, which can extend the customer purchasing cycle. We have experienced this with our IGRT products, and expect this to be even greater with our proton therapy products because of the high cost of the equipment and the complexity of project financing. With the current general worldwide economic downturn and contraction in credit markets, as well as the uncertainty surrounding healthcare reform and changes to reimbursement rates, the purchasing cycle has extended and may extend even further as potential customers more closely scrutinize and prioritize their capital spending budgets, and analyze appropriate financing alternatives. With larger projects, such as the purchase of a proton therapy system, the contraction in credit markets could cause customers to delay or cancel their projects, or request our participation in financing arrangements or payment concessions in their agreements with us, which could negatively impact our cash flows and results of operations. In addition, some of our more sophisticated equipment, such as IGRT and proton therapy products, requires greater site preparation and longer construction cycles, which can delay installation. For proton therapy products, this can delay the customer decision cycles even further. The timing of when individual orders are placed, installation is accomplished and the revenues recognized could have an effect our quarterly results.

Once orders are received, factors that may affect whether these orders become revenues and the timing include:

- delay in shipment due, for example, to longer construction projects or unanticipated construction delays at customer locations where our products are to be installed, cancellations or rescheduling by customers, extreme weather conditions, natural disasters, port strikes or manufacturing difficulties;
- delay in the installation and/or acceptance of a product;
- for proton therapy systems, failure to satisfy contingencies associated with an order;
- the method of accounting used to recognize revenue;
- a change in a customer s financial condition or ability to obtain financing; or
- appropriate regulatory approvals or authorizations.

Our quarterly operating results may also be affected by a number of other factors, including:

changes in our or our competitors pricing or discount levels;

changes or anticipated changes in third-party reimbursement amounts or policies applicable to treatments using our products;

revenues becoming affected by seasonal influences;

timing of revenue recognition;

changes in foreign currency exchange rates;

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changes in the relative portion of our revenues represented by our various products, including the relative mix between higher margin and lower margin products;

changes in the relative portion of our revenues represented by the international regions;

timing of the announcement, introduction and delivery of new products or product enhancements by us and by our competitors;

fluctuation in our effective tax rate resulting from various factors, which may or may not be known to us in advance;

disruptions in the supply or changes in the costs of raw materials, labor, product components or transportation services;

disruptions in our operations, including our ability to manufacture products, caused by events such as earthquakes, fires, floods, terrorist attacks or the outbreak of epidemic diseases;

changes in the general economic conditions or tightening of credit available to our customers in the regions in which we do business;

unexpected levels of order cancellations;

the impact of changing levels of sales on sole purchasers of certain of our x-ray products;

the unfavorable outcome of any litigation or administrative proceeding or inquiry;

misleading information in the financial community; and

accounting changes, such as those relating to accounting reserves for product recalls, reserves for excess and obsolete inventories, share-based compensation expense, accounting for income taxes, and adoption of new accounting pronouncements.

Because many of our operating expenses are based on anticipated capacity levels and a high percentage of these expenses are fixed for the short term, a small variation in the timing of revenue recognition can cause significant variations in operating results from quarter to quarter. Our overall gross margin may also be impacted by the gross margin of our proton therapy products, which are presently below the gross margins for our traditional radiotherapy products. If our gross margins fall below the expectation of securities analysts and investors, the trading price of VMS common stock would almost certainly decline.

We report on a quarterly and annual basis our net orders and backlog. It is important to understand that, unlike revenues, net orders and backlog are not governed by the rules of GAAP, and are not within the scope of the audit or reviews conducted by our independent registered public accounting firm; therefore, investors should not interpret our net orders or backlog in such a manner. Also, for the reasons set forth above, our net orders and backlog cannot necessarily be relied upon as accurate predictors of future revenues. Unexpected levels of cancellation of orders or delays in customer purchase decisions or delivery dates will reduce the quarterly net orders and backlog and also affect the level of future revenues. Accordingly, we cannot be sure if or when orders will mature into revenues. Our net orders, backlog, revenues and net earnings in one or more future periods may fall below the expectations of securities analysts and investors. In that event, the trading price of VMS common stock would almost certainly decline.

THE FINANCIAL RESULTS OF OUR VARIAN PARTICLE THERAPY BUSINESS MAY FLUCTUATE AND BE UNPREDICTABLE

Our proton therapy projects are highly customized and vary in size and complexity. Planning for these projects will take more time and use more resources than those in the radiotherapy business conducted in our Oncology Systems segment. Due to its relatively large scale, the construction of a proton therapy facility requires significant capital investment and may involve complex project financing. If we are required to establish special purpose entities to finance and manage a proton therapy project, we may be required to consolidate these special purpose entities in our financial statements, or guarantee performance and assume liabilities that are in excess of the project value, which could negatively impact our financial results. Further, the current worldwide economic downturn and contraction in credit markets may make it more difficult for potential customers of this business to find appropriate financing for large proton therapy projects, which could cause them to delay or cancel their projects, or request participation in financing arrangements or payment concessions in their agreements with us.

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In addition, due to their size and complexity, the sales and customer decision cycles for proton therapy projects may take several years. As a result, the timing of these projects, and therefore our operating results for this business, may vary significantly from period to period.

We expect that a limited number of customers will account for a substantial portion of our Particle Therapy business for the foreseeable future. Because an order for a proton therapy system can be relatively large, an order in one fiscal period will cause our financial results to vary significantly, making comparisons between fiscal periods more difficult. Further, the award of a proton therapy system orders may be subject to challenge by third parties, which can make the certainty of these orders unpredictable. If a customer cancels an order for a proton therapy system, it would negatively impact our orders in the fiscal period in which the order is cancelled, and we would lose product and services revenues, which would adversely affect our financial results.

In addition, many of the components used in proton therapy equipment require a long lead time, which may require an increase in our levels of inventory. This may cause fluctuations in the operating results of our Varian Particle Therapy business that may make it difficult to predict our operating results and to compare our financial results from period to period.

Moreover, entrance into the proton therapy business may subject us to increased risk and potential liability. For example, because proton therapy projects are large in scale and require detailed project planning, failure to deliver on our commitments could result in greater than expected liabilities, as we could be required to indemnify business partners and customers for losses suffered or incurred if we are unable to deliver our products in accordance with the terms of customer contracts. The greater size of proton projects means that the potential liability could similarly be greater. Additionally, customers are requesting that the systems vendor, as the primary technology provider, provide guarantees for and suffer penalties in relation to the overall construction project. Since the cost of each proton therapy center project may exceed $100 million, the amount of potential liability may be higher than the levels historically assumed by us for our traditional radiation therapy business. Insurance covering these contingencies may be unobtainable. If we cannot reasonably mitigate or eliminate these contingencies, our ability to competitively bid upon proton center projects will be negatively impacted and we may be required to assume material amounts of potential liability, all of which may have adverse consequences to our Varian Particle Therapy business. In addition, we have encountered and may encounter additional challenges in the commercialization of the proton therapy products, which may increase our research and development costs and delay the introduction of our products. This and other unanticipated events could adversely affect our business and make our results of operations unpredictable.

WE HAVE ENTERED INTO A CREDIT FACILITY AGREEMENT THAT RESTRICTS CERTAIN ACTIVITIES, AND FAILURE TO COMPLY WITH THIS AGREEMENT MAY HAVE AN ADVERSE EFFECT ON OUR BUSINESS, LIQUIDITY AND FINANCIAL POSITION

We maintain a revolving credit facility that contains restrictive financial covenants, including financial covenants that require us to comply with specified financial ratios. We may have to curtail some of our operations to comply with these covenants. In addition, our revolving credit facility contains other affirmative and negative covenants that could restrict our operating and financing activities. These provisions limit our ability to, among other things, incur future indebtedness, contingent obligations or liens, guarantee indebtedness, make certain investments and capital expenditures, sell stock or assets and pay dividends, and consummate certain mergers or acquisitions. Because of the restrictions on our ability to create or assume liens, we may find it difficult to secure additional indebtedness if required. Furthermore, if we fail to comply with the credit facility requirements, we may be in default, and we may not be able to obtain the necessary amendments to the credit agreement or waivers of an event of default. Upon an event of default if the credit agreement is not amended or the event of default is not waived, the lender could declare all amounts outstanding, together with accrued interest, to be immediately due and payable. If this happens, we may not be able to make those payments or borrow sufficient funds from alternative sources to make those payments. Even if we were to obtain additional financing, that financing may be on unfavorable terms.

CHANGES IN INTERPRETATION OR APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES MAY ADVERSELY AFFECT OUR OPERATING RESULTS

We prepare our financial statements to conform with GAAP. These principles are subject to interpretation by the FASB, American Institute of Certified Public Accountants, the Public Company Accounting Oversight Board, the Securities and Exchange Commission and various other regulatory or accounting bodies. A change in interpretations of, or our application of, these principles can have a significant effect on our reported results and may even affect our reporting of transactions completed before a change is announced. Additionally, as we are required to adopt new accounting standards, our methods of accounting for certain items may change, which could cause our results of operations to fluctuate from period to period.

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For example, as a result of our adoption of the provisions in ASC 740 related to accounting for uncertainty in income taxes, our effective tax rate and other related financial metrics have fluctuated and may in the future fluctuate more than they have in prior periods.

As our operations evolve over time, we may introduce new products or new technologies that require us to apply different accounting principles, including that regarding revenue recognition, than we have applied in past periods. Additionally, we recognize revenues for some of our proton therapy products and services and for certain highly customized image detection systems in our SIP business under the percentage-of-completion method or the completed-contract method, which affects the timing of revenue recognition. We could be required to apply these methods to other businesses in the future. The percentage-of-completion method involves considerable use of estimates in determining revenues, costs and profits and in assigning dollar amounts to relevant accounting periods which must be periodically reviewed and appropriately adjusted. If our estimates prove to be inaccurate or circumstances change over time, we would be required to adjust revenues or even record a contract loss in later periods, and our financial results could suffer. In addition, if a loss is expected on a contract under the percentage-of-completion method and completed contract method, the estimated loss would be charged to cost of sales in the period the loss is identified. The application of different types of accounting principles and related potential changes may make it more difficult to compare our financial results from quarter to quarter, and the trading price of VMS common stock could suffer or become more volatile as a result.

ENVIRONMENTAL LAWS IMPOSE COMPLIANCE COSTS ON OUR BUSINESS AND CAN ALSO RESULT IN LIABILITY

We are subject to environmental laws around the world. These laws regulate many aspects of our operations, including our handling, storage, transport and disposal of hazardous materials. They can also impose cleanup liabilities, including with respect to discontinued operations. Although we follow procedures intended to comply with existing environmental laws, we, like other businesses, can never completely eliminate the risk of contamination or injury from certain materials that we use in our business and, therefore, the prospect of resulting claims and damage payments. We may also be assessed fines or penalties for failure to comply with environmental laws and regulations. As a consequence of these various elements, we can incur significant environmental costs and liabilities, some recurring and reasonably predictable, and others not recurring or easily predicted. Although insurance has provided coverage for portions of cleanup costs resulting from historical occurrences, we maintain only limited insurance coverage for costs or claims that might result from any future contamination.

Future changes in environmental laws could also increase our costs of doing business, perhaps significantly. Several countries, including some in the EU, now require medical equipment manufacturers to bear certain disposal costs, of products at the end of a product s useful life, thus creating increased costs for our operations. The EU has also adopted a directive that may lead to restrictions on the use of certain hazardous substances in some of our products sold there. These directives, along with another that requires material disclosure information to be provided upon request, could create increased costs for our operations. All of these costs, and any future violations or liabilities under environmental laws or regulations, could have a material adverse effect on our business.

AS A STRATEGY TO ASSIST OUR SALES EFFORTS, WE MAY OFFER EXTENDED PAYMENT TERMS, WHICH MAY POTENTIALLY RESULT IN HIGHER DSO AND GREATER PAYMENT DEFAULTS

We offer longer or extended payment terms for qualified customers in some circumstances. As of January 1, 2010, customer contracts with extended payment terms of more than one year amounted to less than 1% of our accounts receivable balance. While we qualify customers to whom we offer longer or extended payment terms, their financial positions may change adversely over the longer time period given for payment. This may result in an increase in payment defaults, which would affect our net earnings. Also, longer or extended payment terms have and may in the future result in an increase in our days sales outstanding.

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DISRUPTION OF CRITICAL INFORMATION SYSTEMS COULD HARM OUR BUSINESS AND FINANCIAL CONDITION

Information technology helps us operate efficiently, interface with customers, maintain financial accuracy and efficiency, and accurately produce our financial statements. If we do not allocate and effectively manage the resources necessary to build and sustain the proper technology infrastructure, we could be subject to transaction errors, processing inefficiencies, the loss of customers, business disruptions, or the loss of or damage to intellectual property through security breach. If our data management systems do not effectively collect, store, process and report relevant data for the operation of our business, whether due to equipment malfunction or constraints, software deficiencies, or human error, our ability to effectively plan, forecast and execute our business plan and comply with applicable laws and regulations will be impaired, perhaps materially. Any such impairment could materially and adversely affect our financial condition, results of operations, cash flows and the timeliness with which we report our internal and external operating results.

OUR OPERATIONS ARE VULNERABLE TO INTERRUPTION OR LOSS DUE TO NATURAL OR OTHER DISASTERS, POWER LOSS, STRIKES AND OTHER EVENTS BEYOND OUR CONTROL

We conduct a significant portion of our activities, including manufacturing, administration and data processing at facilities located in the State of California and other seismically active areas that have experienced major earthquakes in the past, as well as other disasters. We carry limited earthquake insurance that may not be adequate or continue to be available at commercially reasonable rates and terms. A major earthquake or other disaster affecting our facilities (such as a major fire, flood or terrorist attack), or those of our suppliers, could significantly disrupt our operations, and delay or prevent product manufacture and shipment during the time required to repair, rebuild or replace our or our suppliers damaged manufacturing facilities; these delays could be lengthy and costly. If any of our customers facilities are adversely affected by a disaster, shipments of our products could be delayed. In addition, our facilities, particularly those located in the western states of the United States, may be subject to a shortage of available electrical power and other energy supplies. Any shortages may increase our costs for power and energy supplies or could result in blackouts, which could disrupt the operations of our affected facilities and harm our business. Further, our products are typically shipped from a limited number of ports, and any disaster, strike or other event blocking shipment from these ports could delay or prevent shipments and harm our business.

THE EFFECT OF TERRORISM OR AN OUTBREAK OF EPIDEMIC DISEASES MAY NEGATIVELY AFFECT SALES AND HINDER OUR OPERATIONS

Concerns about terrorism, the effects of a terrorist attack or an outbreak of epidemic diseases, such as the swine flu, could have a negative effect on our business operations, those of our suppliers and customers, and the ability to travel, resulting in adverse consequences on our revenues and financial performance.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Not applicable

(b) Not applicable

(c) The following table provides information with respect to the shares of common stock repurchased by us during the first quarter of fiscal year 2010.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)
October 3, 2009 - October 30, 2009	250,000	$ 40.39	250,000	7,050,000
October 31, 2009 - November 27, 2009	1,007,578(2)	$ 45.08	1,000,000	6,050,000
November 28, 2009 - January 1, 2010		$		5,000,000
Total	1,257,578	$ 44.15	1,250,000	

(1) On November 17, 2008, VMS s Board of Directors authorized the repurchase of 8,000,000 shares of VMS common stock from January 1, 2009 through December 31, 2009. The authorization expired on December 31, 2009 with 6,050,000 shares available for repurchase. On November 13, 2009, VMS s Board of Directors authorized the repurchase of an additional 5,000,000 shares of VMS common stock from January 1, 2010 through December 31, 2010. We expect repurchases under the November 13, 2009 authorization will be made in accordance with Rule 10b-18 and include plans designed to satisfy the Rule 10b5-1 safe harbor. Shares will be retired upon repurchase.

(2) Includes 7,578 shares of VMS common stock that were tendered to VMS in satisfaction of tax withholding obligations upon the vesting of restricted common stock granted under the Company s employee stock plans.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

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Item 6. Exhibits

(a) Exhibits required to be filed by Item 601 of Regulation S-K:

Exhibit No.	Description
15.1	Letter Regarding Unaudited Interim Financial Information.
31.1	Chief Executive Officer Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act.
31.2	Chief Financial Officer Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act.
32.1	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Attached as Exhibit 101 to this Quarterly Report on Form 10-Q are the following formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Statements of Earnings for the three months ended January 1, 2010 and January 2, 2009; (ii) Condensed Consolidated Statements of Earnings for the three months ended January 1, 2010 and January 2, 2009; (iii) Condensed Consolidated Balance Sheets at January 1, 2010 and October 2, 2009; (iv) Condensed Consolidated Statements of Cash Flows for the three months ended January 1, 2010 and January 2, 2009; and (v) Notes to Condensed Consolidated Financial Statements for the three months ended January 1, 2010.

In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

VARIAN MEDICAL SYSTEMS, INC.
(Registrant)

Dated: February 9, 2010

By: /s/ **Elisha W. Finney**
Elisha W. Finney
Senior Vice President, Finance and
Chief Financial Officer
(Duly Authorized Officer and
Principal Financial Officer)

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