VARIAN MEDICAL SYSTEMS INC
Form 10-Q
August 11, 2009
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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 July 3, 2009**

**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: 125,530,482 shares of common stock, par value $1 per share, outstanding as of July 31, 2009.

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**VARIAN MEDICAL SYSTEMS, INC.**

**FORM 10-Q for the Quarter Ended July 3, 2009**

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**PART I**

**FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS**

**(Unaudited)**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| **(In thousands, except per share amounts)** | **July 3, 2009** | **June 27, 2008** | **July 3, 2009** | **June 27, 2008** |
| Revenues: | | | | |
| Product | $ 396,888 | $ 410,065 | $ 1,248,349 | $ 1,203,182 |
| Service contracts and other | 112,983 | 97,352 | 323,782 | 273,850 |
| Total revenues | 509,871 | 507,417 | 1,572,131 | 1,477,032 |
| Cost of revenues: | | | | |
| Product | 228,249 | 223,686 | 717,663 | 697,609 |
| Service contracts and other | 65,382 | 71,397 | 178,880 | 164,422 |
| Total cost of revenues | 293,631 | 295,083 | 896,543 | 862,031 |
| Gross margin | 216,240 | 212,334 | 675,588 | 615,001 |
| Operating expenses: | | | | |
| Research and development | 35,325 | 35,650 | 109,282 | 96,473 |
| Selling, general and administrative | 78,427 | 84,546 | 242,843 | 234,705 |
| Total operating expenses | 113,752 | 120,196 | 352,125 | 331,178 |
| Operating earnings | 102,488 | 92,138 | 323,463 | 283,823 |
| Interest income | 687 | 2,602 | 3,826 | 8,150 |
| Interest expense | (920) | (1,304) | (3,067) | (3,774) |
| Earnings from continuing operations before taxes | 102,255 | 93,436 | 324,222 | 288,199 |
| Taxes on earnings | 16,904 | 16,380 | 89,934 | 80,016 |
| Earnings from continuing operations | 85,351 | 77,056 | 234,288 | 208,183 |
| Loss from discontinued operations, net of taxes | | (2,876) | (12,327) | (7,161) |
| Net earnings | $ 85,351 | $ 74,180 | $ 221,961 | $ 201,022 |
| Net earnings (loss) per share - Basic | | | | |
| Continuing operations | $ 0.69 | $ 0.62 | $ 1.89 | $ 1.67 |

| | | | | |
|---|---|---|---|---|
| Discontinued operations | $ | $ (0.02) | $ (0.10) | $ (0.06) |
| Net earnings per share | $ 0.69 | $ 0.60 | $ 1.79 | $ 1.61 |
| Net earnings (loss) per share - Diluted | | | | |
| Continuing operations | $ 0.68 | $ 0.61 | $ 1.88 | $ 1.63 |
| Discontinued operations | $ | $ (0.03) | $ (0.10) | $ (0.05) |
| Net earnings per share | $ 0.68 | $ 0.58 | $ 1.78 | $ 1.58 |
| Weighted average shares used in the calculation of: | | | | |
| Net earnings per share - Basic | 124,237 | 124,617 | 123,961 | 124,850 |
| Net earnings per share - Diluted | 124,991 | 127,065 | 124,898 | 127,629 |

*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) | July 3, 2009 | September 26, 2008 [1] |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 471,721 | $ 397,306 |
| Restricted cash | 2,629 | |
| Accounts receivable, net of allowance for doubtful accounts of $4,559 at July 3, 2009 and $3,110 at September 26, 2008 | 469,523 | 486,310 |
| Inventories | 358,151 | 282,980 |
| Prepaid expenses and other current assets | 60,544 | 78,018 |
| Deferred tax assets | 130,941 | 130,988 |
| Current assets of discontinued operations | | 18,799 |
| Total current assets | 1,493,509 | 1,394,401 |
| Property, plant and equipment, net | 260,297 | 218,183 |
| Goodwill | 207,687 | 209,146 |
| Other assets | 166,077 | 150,694 |
| Long-term assets of discontinued operations | | 3,088 |
| **Total assets** | $ 2,127,570 | $ 1,975,512 |
| **Liabilities and Stockholders Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 88,259 | $ 105,281 |
| Accrued expenses | 239,775 | 252,915 |
| Product warranty | 46,779 | 51,141 |
| Deferred revenues | 124,219 | 141,368 |
| Advance payments from customers | 249,450 | 201,783 |
| Current maturities of long-term debt | 9,001 | 7,987 |
| Current liabilities of discontinued operations | | 21,202 |
| Total current liabilities | 757,483 | 781,677 |
| Long-term debt | 23,459 | 32,399 |
| Other long-term liabilities | 117,561 | 134,251 |
| Total liabilities | 898,503 | 948,327 |
| 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; 125,530 and 125,590 shares issued and outstanding at July 3, 2009 and at September 26, 2008, respectively | 125,530 | 125,590 |
| Capital in excess of par value | 501,588 | 468,384 |
| Retained earnings | 620,743 | 451,439 |

| | | |
|---|---|---|
| Accumulated other comprehensive loss | (18,794) | (18,228) |
| Total stockholders equity | 1,229,067 | 1,027,185 |
| **Total liabilities and stockholders equity** | $ 2,127,570 | $ 1,975,512 |

(1) The condensed consolidated balance sheet as of September 26, 2008 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)**

| | Nine Months Ended | |
|---|---|---|
| **(In thousands)** | **July 3, 2009** | **June 27, 2008** |
| **Cash flows from operating activities:** | | |
| Net earnings | $ 221,961 | $ 201,022 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Share-based compensation expense | 32,158 | 30,154 |
| Tax benefits from exercises of share-based payment awards | 5,836 | 26,851 |
| Excess tax benefits from share-based compensation | (7,375) | (24,273) |
| Depreciation | 30,042 | 23,490 |
| Amortization of intangible assets | 2,651 | 3,463 |
| Deferred taxes | (4,415) | (2,910) |
| Provision for doubtful accounts receivable | 1,658 | 485 |
| Net change in fair value of derivatives and underlying commitments | 1,765 | 5,035 |
| (Income) loss on equity investment in affiliate | 2,298 | (293) |
| Loss on sale of Research Instruments | 8,062 | |
| Other | (2,449) | (2,108) |
| Changes in assets and liabilities: | | |
| Restricted Cash | (2,629) | |
| Accounts receivable | 9,202 | 90,677 |
| Inventories | (75,591) | (66,448) |
| Prepaid expenses and other current assets | (11,109) | (33,853) |
| Accounts payable | (19,627) | 3,611 |
| Accrued expenses | (3,740) | (23,580) |
| Deferred revenues | (17,188) | 36,290 |
| Product warranty | (4,807) | 1,118 |
| Advance payments from customers | 45,054 | 25,202 |
| Other long-term liabilities | (23,224) | (3,745) |
| Net cash provided by operating activities | 188,533 | 290,188 |
| **Cash flows from investing activities:** | | |
| Purchases of property, plant and equipment | (47,931) | (59,331) |
| Acquisition of business, net of cash acquired | (2,550) | (1,291) |
| (Increase) decrease in cash surrender value of life insurance | (2,386) | 2,500 |
| Note receivable from affiliate and other, net | (5,988) | (807) |
| Other, net | (4,171) | (349) |
| Net cash used in investing activities | (63,026) | (59,278) |
| **Cash flows from financing activities:** | | |
| Repurchases of common stock | (71,541) | (176,438) |
| Proceeds from issuance of common stock to employees | 16,897 | 63,065 |
| Excess tax benefits from share-based compensation | 7,375 | 24,273 |
| Employees taxes withheld and paid for restricted stock | (2,767) | (345) |
| Repayments of bank borrowings | (7,926) | (8,913) |
| Net borrowings under line of credit agreements | | 25,895 |

| | | |
|---|---|---|
| Other | (192) | (92) |
| Net cash used in financing activities | (58,154) | (72,555) |
| Effects of exchange rate changes on cash and cash equivalents | 7,062 | (15,917) |
| Net increase in cash and cash equivalents | 74,415 | 142,438 |
| Cash and cash equivalents at beginning of period | 397,306 | 263,246 |
| Cash and cash equivalents at end of period | $ 471,721 | $ 405,684 |

*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 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.

***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 2009 is the 53-week period ending October 2, 2009, and fiscal year 2008 was the 52-week period that ended on September 26, 2008. The fiscal quarter ended July 3, 2009 and the fiscal quarter ended June 27, 2008 were 13-week periods.

***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.

***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 September 26, 2008 (the 2008 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 July 3, 2009 and September 26, 2008, results of operations for the three and nine months ended July 3, 2009 and June 27, 2008, and cash flows for the nine months ended July 3, 2009 and June 27, 2008. The Company has evaluated subsequent events through August 11, 2009, the date the Company filed its Quarterly Report on Form 10-Q for the quarter ended July 3, 2009. The results of operations for the three and nine months ended July 3, 2009 are not necessarily indicative of the operating results to be expected for the full fiscal year or any future period.

***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, restricted cash, 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 $33.9 million at July 3, 2009 and $42.2 million at September 26, 2008. The fair value of long-term debt was estimated based on the then-current rates available to the Company for debt of similar terms and remaining maturities. The Company determined the estimated fair

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**(Unaudited)**

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 and Security and Inspection Products ( SIP ) 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 Other, the Company recognizes revenues for hardware products in accordance with Staff Accounting Bulletin ( SAB ) No. 104, *Revenue Recognition* ( SAB 104 ), when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable and collectibility is reasonably assured. For an arrangement with multiple deliverables, the Company recognizes product revenues in accordance with Emerging Issues Task Force ( EITF ) No. 00-21, *Revenue Arrangements with Multiple Deliverables* ( EITF 00-21 ) and EITF No. 03-05, *Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software*, 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 under SAB 104 and EITF 00-21 are 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 EITF 00-21.

Installation of Oncology Systems and SIP hardware products involves the Company s testing of each product at its factory prior to its 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 criteria under SAB 104 and EITF 00-21 have been met.

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**(Unaudited)**

**Software Products**

Except as described below under Other, the Company recognizes revenues for software products in accordance with Statement of Position ( SOP ) No. 97-2, *Software Revenue Recognition* ( SOP 97-2 ), as amended by SOP No. 98-9, *Software Revenue Recognition with Respect to Certain Agreements*. The Company recognizes license revenues when all of the following criteria are 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 under SOP 97-2 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 under SOP 97-2 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 under SOP 97-2 are met.

**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 SOP No. 81-1, *Accounting for Performance of Construction-Type and Certain Product Type Contracts*. 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 as of the end of each period represents the amount of unrecognized hardware and software revenues that was invoiced.

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**(Unaudited)**

***Recent Accounting Pronouncements***

In April 2009, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position ( FSP ) No. FAS 107-1 and Accounting Principles Bulletin ( APB ) 28-1, *Interim Disclosures about Fair Value of Financial Instruments,* ( FSP 107-1 ). FSP 107-1 amends FASB No. 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. FSP 107-1 also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods. The adoption of FSP 107-1 in the third quarter of fiscal year 2009 did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued Statement of Financial Accounting Standards ( SFAS ) No. 141 (revised 2007), *Business Combinations* ( SFAS 141(R) ). SFAS 141(R) 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. SFAS 141(R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. In April 2009, the FASB issued FSP No. FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* ( FSP 141(R)-1 ). FSP 141(R)-1 amends and clarifies SFAS 141(R) on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The provisions of SFAS 141(R) and FSP No. 141(R)-1 will be effective for the Company in the first quarter of fiscal year 2010. The impact of the adoption of SFAS 141(R) and FSP No. 141(R)-1 will depend on the nature and extent of business combinations occurring on or after the beginning of fiscal year 2010.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51* ( SFAS 160 ). SFAS 160 establishes accounting and reporting standards 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. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. The provisions of SFAS 160 will be effective for the Company in the first quarter of fiscal year 2010. The Company does not expect that the adoption of SFAS 160 will have a material impact on its consolidated financial position, results of operations and cash flows.

In November 2008, the FASB ratified EITF Issue No. 08-6, *Equity Method Investment Accounting Considerations* ( EITF 08-6 ). EITF 08-6 clarifies the accounting for certain transactions and impairment considerations involving equity method investments. The provisions of EITF 08-6 will be effective for the Company in the first quarter of fiscal year 2010, with early adoption prohibited. The Company is currently assessing the potential impact, if any, EITF 08-6 may have on its consolidated financial position, results of operations and cash flows.

In December 2008, the FASB issued FSP No. FAS 132(R)-1, *Employers Disclosures about Postretirement Benefit Plan Assets* ( FSP 132(R)-1 ). FSP 132(R)-1, which amends SFAS 132(R), *Employers Disclosures about Pensions and Other Postretirement Benefits*, provides guidance on an employer s disclosure about plan assets of a defined benefit pension or other postretirement plan and requires employers to disclose information about fair value measurements of plan assets similar to the disclosure about fair value measurements requirement under SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ). The provisions of FSP No. 132(R)-1 will be effective for the Company as of the end of fiscal year 2010.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* ( SFAS 165 ), which establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. The adoption of SFAS 165 in the third quarter of fiscal year 2009 did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* ( SFAS 167 ). SFAS 167 amends the consolidation guidance for variable-interest entities under FASB Interpretations No. 46(R), *Consolidation of Variable Interest Entities: an interpretation of ARB No. 51*, 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

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**(Unaudited)**

significantly impact the entity s economic performance. The provisions of SFAS 167 will be effective for the Company in the first quarter of fiscal year 2011. The Company is currently assessing the potential impact, if any, SFAS 167 may have on its consolidated financial position, results of operations and cash flows.

On July 1, 2009, the FASB released the authoritative version of its new *Accounting Standards Codification* (the Codification ) as the single authoritative source for GAAP. The Codification replaces all previous GAAP accounting standards as described in SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* ( SFAS 168 ). While not intended to change GAAP, the Codification significantly changes the way in which the accounting literature is organized. It is structured by accounting topic to help accountants and auditors more quickly identify the guidance that applies to a specific accounting issue. The provisions of SFAS 168 will be effective for the Company in the fourth quarter of fiscal year 2009. The adoption of the Codification will not have an effect on the Company s consolidated financial position, results of operations and cash flows. However, because the Codification completely replaces existing standards, it will affect the way GAAP is referenced by the Company in its consolidated financial statements.

***Reclassifications***

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

**2. BALANCE SHEET COMPONENTS:**

The components of inventories are as follows:

| (In millions) | July 3, 2009 | September 26, 2008 |
|---|---|---|
| Raw materials and parts | $ 203.8 | $ 156.8 |
| Work-in-progress | 49.2 | 36.6 |
| Finished goods | 105.2 | 89.6 |
| Total inventories | $ 358.2 | $ 283.0 |

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**(Unaudited)**

| (In millions) | July 3, 2009 | September 26, 2008 |
|---|---|---|
| ***Property, plant and equipment:*** | | |
| Land, land leaseholds and land improvements | $ 42.5 | $ 11.4 |
| Buildings and leasedhold improvements | 182.4 | 167.6 |
| Machinery and equipment[(1)] | 275.6 | 226.3 |
| Construction in progress | 18.8 | 46.5 |
| Assets subject to lease | 0.8 | 0.8 |
| | 520.1 | 452.6 |
| Accumulated depreciation and amortization | (259.8) | (234.4) |
| Property, plant and equipment, net | $ 260.3 | $ 218.2 |

(1) The balance at July 3, 2009 includes capitalized costs associated with the implementation of the Company s enterprise resource planning system ( ERP ), which was placed in service in the second quarter of fiscal year 2009 and was previously disclosed in construction in progress.

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

| (In millions) | July 3, 2009 | September 26, 2008 |
|---|---|---|
| Long-term income taxes payable | $ 65.6 | $ 89.5 |
| Other | 52.0 | 44.8 |
| Total other long-term liabilities | $ 117.6 | $ 134.3 |

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 as of July 3, 2009. As of September 26, 2008, the Other category of other long-term liabilities primarily consisted of accruals for environmental costs, accrued pension and post-retirement benefits and deferred income tax liabilities.

**3. FAIR VALUE**

Effective September 27, 2008, the Company adopted SFAS 157, which defines fair value 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. SFAS 157 establishes 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.

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**(Unaudited)**

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 instruments 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 July 3, 2009, 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).

The Company s adoption of SFAS 157 did not have a material impact on its consolidated financial statements. The Company has segregated all financial 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. FSP No. FAS 157-2 delayed the effective date of SFAS 157 for all nonfinancial assets and liabilities until the first quarter of fiscal year 2010, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis.

Effective September 27, 2008, the Company adopted SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115* ( SFAS 159 ), which provides entities the option to measure many financial instruments and certain other items at fair value. The Company has currently chosen not to elect the fair value option for any items that are not already required to be measured at fair value in accordance with GAAP.

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

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**(Unaudited)**

***Assets/Liabilities Measured at Fair Value on a Recurring Basis***

The following tables present the Company s financial assets as of July 3, 2009 that are measured at fair value on a recurring basis. There were no financial liabilities that were measured at fair value as of July 3, 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:** | | | | |
| Money market funds | $ 22.0 | $ | $ | $ 22.0 |
| Derivative assets | | 0.3 | | 0.3 |
| Total assets measured at fair value | $ 22.0 | $ 0.3 | $ | $ 22.3 |

| | 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:** | | | | |
| Cash and cash equivalents | $ 21.0 | $ | $ | $ 21.0 |
| Prepaid expenses | | 0.3 | | 0.3 |
| Other assets | 1.0 | | | 1.0 |
| Total assets measured at fair value | $ 22.0 | $ 0.3 | $ | $ 22.3 |

**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) | July 3, 2009 | September 26, 2008 |
|---|---|---|
| ***Intangible Assets:*** | | |
| Acquired existing technology | $ 20.7 | $ 19.7 |
| Patents, licenses and other | 14.7 | 14.5 |
| Customer contracts and supplier relationships | 10.4 | 10.5 |
| Accumulated amortization | (36.2) | (33.6) |
| Net carrying amount | $ 9.6 | $ 11.1 |

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

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**(Unaudited)**

Amortization expense for intangible assets required to be amortized under SFAS No.142, *Goodwill and Other Intangible Assets* ( SFAS 142 ), was $0.9 million and $1.0 million for the three months ended July 3, 2009 and June 27, 2008, respectively, and $2.7 million and $3.3 million for the nine months ended July 3, 2009 and June 27, 2008, respectively. The Company estimates amortization expense on a straight-line basis for the remaining three months of fiscal year 2009, fiscal years 2010 through 2013 and thereafter, to be as follows (in millions): $0.9, $3.2, $2.4, $1.6, $1.2 and $0.3, respectively.

The following table reflects the allocation of goodwill:

| (In millions) | July 3, 2009 | September 26, 2008 |
|---|---|---|
| Oncology Systems | $ 126.7 | $ 125.4 |
| X-ray Products | 2.7 | 2.7 |
| Other | 78.3 | 81.0 |
| Total | $ 207.7 | $ 209.1 |

The change in goodwill balance in the Other category reflects the impact of foreign currency translation adjustments and the sale of Research Instruments. The increase in goodwill balance in Oncology Systems was due to an acquisition.

**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®, or 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 loss on the equity investment in dpiX Holding of $2.3 million in the three months ended July 3, 2009 and income of $1 million in the three months ended June 27, 2008. VMS recorded a loss on the equity investment in dpiX Holding of $2.3 million in the nine months ended July 3, 2009 and income of $0.3 million in the nine months ended June 27, 2008. Income and loss on the equity investment in dpiX Holding are included in Selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings.

In accordance with the dpiX agreement, 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 December 2004, VMS agreed to loan $2 million to dpiX in four separate installments, 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 that began in October 2006; interest is payable in full according to a quarterly schedule, which began in April 2005; and the entire

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

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principal balance, together with accrued and unpaid interest thereon and all other related amounts payable thereunder, was due and payable on July 10, 2009. The note receivable from dpiX of $0.2 million and $0.7 million at July 3, 2009 and September 26, 2008, respectively, was included in Prepaid expenses and other current assets in the Condensed Consolidated Balance Sheets.

In February 2008, VMS agreed to loan an additional $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 additional note receivable from dpiX of $1.6 million at both July 3, 2009 and September 26, 2008 was primarily included in Other assets in the Condensed Consolidated Balance Sheets.

In February 2009, VMS agreed to loan a further $14 million to dpiX in four separate installments over a period through October 2009. 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 July 3, 2009, VMS had loaned $6.8 million to dpiX under this loan agreement, which was included in Other assets in the Condensed Consolidated Balance Sheet as of that date.

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 July 3, 2009 and September 26, 2008, 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 July 3, 2009 and June 27, 2008, the Company purchased glass transistor arrays from dpiX totaling approximately $7.3 million and $7.0 million, respectively. Glass transistor arrays purchased from dpiX totaled $21.5 million for the nine months ended July 3, 2009 and $18.6 million for the nine months ended June 27, 2008. 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.

**6. PRODUCT WARRANTY**

The following table reflects the changes in the Company s accrued product warranty during the nine months ended July 3, 2009 and June 27, 2008:

| | Nine Months Ended | |
|---|---|---|
| **(In millions)** | **July 3, 2009** | **June 27, 2008** |
| Accrued product warranty, at beginning of period | $ 51.1 | $ 51.3 |
| Charged to cost of revenues | 38.3 | 36.7 |
| Actual product warranty expenditures | (42.6) | (35.6) |
| Accrued product warranty, at end of period | $ 46.8 | $ 52.4 |

**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 (the Amended BofA Credit Facility ) to increase the line of credit 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 under the terms of the Amended BofA Credit Facility. As of July 3, 2009, VMS has pledged to BofA 65% of the voting shares that it holds in Varian Medical Systems Nederland B.V., a wholly-owned subsidiary. The Amended BofA Credit

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Facility may be used for working capital, capital expenditures, permitted acquisitions and other lawful corporate purposes. The Amended BofA Credit Facility will expire, if not extended by mutual agreement of VMS and BofA, on November 10, 2011. Borrowings under the Amended BofA Credit Facility 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.

There were no outstanding balances under the BofA Credit Facility as of September 26, 2008 and July 3, 2009. The Amended BofA Credit Facility also provided $25 million to support letters of credit issued on behalf of the Company, of which none were outstanding as of July 3, 2009.

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. As of July 3, 2009, the Company was in compliance with all covenants. See Note 17, Subsequent Event for more information.

**8. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

Pursuant to SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 149, *Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities* ( SFAS 133 ), 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 at July 3, 2009 were as follows:

| | Asset Derivatives | | Liability Derivatives | |
|---|---|---|---|---|
| (In millions) | Balance Sheet Location | July 3, 2009 Fair Value | Balance Sheet Location | July 3, 2009 Fair Value |
| Derivative designated as hedging instruments under SFAS 133: | | | | |
| Foreign exchange forward contracts | Prepaid Expenses | $ 0.3 | Accrued liabilities | $ |
| Total derivatives | | $ 0.3 | | $ |

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 2008 Annual Report regarding credit risk associated with the Company s derivative instruments.

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

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**(Unaudited)**

***Cash Flow Hedging Activities***

The Company has many transactions denominated in foreign currencies and addresses certain of those financial exposures through a program of risk management that includes the use of derivative financial instruments. The Company sells products throughout the world, often in the local currency of the customer s country, and typically hedges certain of these larger foreign currency transactions when they are not 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 July 3, 2009, 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 SFAS 133, 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 SFAS 133, 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 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 and nine months ended July 3, 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 July 3, 2009, all forecasted cash flows are still probable to occur. The Company did not have any cash flow hedges in the three and nine months ended June 27, 2008. As of July 3, 2009, net unrealized gain on derivative instruments of $0.5 million, before tax, is included in Accumulated other comprehensive income (loss), and is expected to be reclassified to net earnings over the next twelve months.

As of July 3, 2009, the Company had the following outstanding foreign exchange forward contracts that were entered into to hedge forecasted revenues:

| (In millions) | Notional Value Sold |
|---|---|
| Euro | $ 14.3 |

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**(Unaudited)**

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:

| (in millions) | Gain (Loss) Recognized in OCI (Effective Portion) Three Months Ended July 3, 2009 | Gain (Loss) Recognized in OCI (Effective Portion) Nine Months Ended July 3, 2009 | Location of Gain (Loss) Reclassified from Accumulated OCI into Net Earnings (Effective Portion) | Gain (Loss) Reclassified from Accumulated OCI into Net Earnings (Effective Portion) Three Months Ended July 3, 2009 | Gain (Loss) Reclassified from Accumulated OCI into Net Earnings (Effective Portion) Nine Months Ended July 3, 2009 |
|---|---|---|---|---|---|
| Foreign exchange contracts | $ (1.3) | $ 7.1 | Revenues | $ 2.4 | $ 5.8 |

The following table presents the 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:

| (in millions) | Location of gain (loss) recognized | Three Months Ended July 3, 2009 | Nine Months Ended July 3, 2009 |
|---|---|---|---|
| Ineffective portion of cash flow hedges - Gain (Loss) | Revenues | $ | $ |
| Amount excluded from assessment of effectiveness of cash flow hedges - Gain (Loss) | Cost of Revenues | $ | $ (0.1) |

***Fair Value Hedging Activities***

The Company has in the past used forward exchange contracts that were designated and qualified as fair value hedges under SFAS 133 for hedging certain of its foreign currency sales orders. During each of the three and nine months ended July 3, 2009 and June 27, 2008, there were no material gains or losses due to hedge ineffectiveness of fair value hedges and there were no material gains or losses recognized when hedged firm commitments no longer qualified as fair value hedges. At July 3, 2009, the Company had no outstanding foreign exchange forward contracts designated as fair value hedges.

***Balance Sheet Hedging Activities***

The Company also hedges balance sheet exposures from its various foreign subsidiaries and business units. 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 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 under SFAS 133. 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 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 freestanding or embedded derivative

instruments.

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**(Unaudited)**

As of July 3, 2009, 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:

| (In millions) | Notional Value Sold | Notional Value Purchased |
|---|---|---|
| Australian dollar | $ 9.5 | $ |
| British pound | | 10.2 |
| Canadian dollar | | 4.1 |
| Danish krone | 4.2 | |
| Euro | 146.1 | 1.5 |
| Indian rupee | 2.4 | |
| Japanese yen | 39.0 | |
| Swedish krona | 0.6 | 1.9 |
| Swiss franc | | 33.8 |
| Totals | $ 201.8 | $ 51.5 |

The following table presents the gains (losses) recognized in the Condensed Consolidated Statements of Earnings related to the foreign currency forward exchange contracts that do not qualify for hedge accounting treatment under SFAS 133.

| Location of Gain or (Loss) Recognized in Income on Derivative | Amount of Gain or (Loss) Recognized in Net Earnings on Derivative | |
|---|---|---|
| (In millions) | Three Months Ended July 3, 2009 | Nine Months Ended July 3, 2009 |
| Selling, general and administrative expenses | $ (6.7) | $ 7.7 |

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 July 3, 2009, the Company did not have any outstanding derivative instruments with credit-risk-related contingent features that were in a net liability position.

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**(Unaudited)**

**9. COMMITMENTS AND CONTINGENCIES**

***Commitments***

In October 2008, VMS consummated an agreement with Varian, Inc. ( VI ), under which VI will 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, will 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 the 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 July 3, 2009, $5 million had been paid to VI pursuant to this agreement and the remaining $16 million will be payable in June 2010. The amount payable to VI is included in Accrued expenses in the Condensed Consolidated Balance Sheet.

***Environmental Remediation Liabilities***

The U.S. Environmental Protection Agency ( EPA ) or third parties have named the Company as a potentially responsible party ( PRP ) under the Comprehensive Environmental Response Compensation and Liability Act of 1980, as amended ( CERCLA ), at nine sites where the Company, as Varian Associates, Inc., was alleged to have shipped manufacturing waste for recycling or disposal and, as a PRP, the Company may have an obligation to reimburse the EPA or other third parties for cleanup costs at these sites. In addition, the Company is overseeing environmental cleanup projects and, as applicable, reimbursing third parties for cleanup activities under the direction of, or in consultation with, federal, state and/or local agencies at certain current VMS or former Varian Associates, Inc. facilities. Under the terms of the agreement governing the Spin-offs of VI and Varian Semiconductor Equipment Associates, Inc. ( VSEA ), by the Company in 1999, VI and VSEA are each obligated to indemnify the Company for one-third of these environmental cleanup costs (after adjusting for any insurance proceeds realized or tax benefits recognized by the Company). The Company spent $0.2 million and $0.1 million (net of amounts borne by VI and VSEA) during the three months ended July 3, 2009 and June 27, 2008, respectively, on environmental cleanup costs, third-party claim costs, project management costs and legal costs. The Company spent $0.7 million and $0.7 million (net of amounts borne by VI and VSEA) during the nine months ended July 3, 2009 and June 27, 2008, respectively, on such costs.

Various uncertainties make it difficult to estimate, or determine the likelihood within a range of estimates of, the project management costs, legal costs and costs of certain third-party claims at all of the sites and facilities. In addition, for the nine sites and one of the facilities, various uncertainties make it difficult to assess the likelihood and scope of further cleanup activities or to estimate the future cost of such activities. As of July 3, 2009, the Company nonetheless estimated that the Company s future exposure (net of VI s and VSEA s indemnification obligations) for the cleanup costs for these ten locations, as well as project management costs, legal costs and the costs of certain third party-claims for all locations ranged in the aggregate from $3.1 million to $7.4 million. Management believes that no amount in the range of estimated future costs is more probable of being incurred than any other amount in the range and therefore accrued $3.1 million for these cleanup projects as of July 3, 2009. The amount accrued has not been discounted to present value due to the uncertainties that make it difficult to develop a best estimate of future costs.

As to all other facilities, the Company has gained sufficient knowledge to better estimate the scope and costs of future cleanup activities based upon formal agreements with other parties defining the Company s future liabilities or formal cleanup plans that have either been approved by or completed in accordance with the requirements of the state or federal environmental agency with jurisdiction over the facility. As of July 3, 2009, the Company estimated that the Company s future exposure (net of VI s and VSEA s indemnification obligations) for the cleanup costs at these facilities, and reimbursements of third party s claims for these facilities, ranged in the aggregate from $7.5 million to $36.4 million. The time frames over which these cleanup project costs are estimated vary, ranging from 1 year to 30 years as of July 3, 2009. As to each of these facilities, management determined that a particular amount within the range of estimated costs was a better estimate of the future environmental liability than any other amount within the range, and that the amount and timing of these future costs were reliably determinable. The best estimate within the range was $15.9 million at July 3, 2009. The Company accordingly accrued $11.4 million, which represents its best estimate of the future costs of $15.9 million discounted at 4%, net of inflation. This accrual is in addition to the $3.1 million described in the preceding

paragraph.

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**(Unaudited)**

The foregoing amounts are only estimates of anticipated future environmental-related costs to cover the known cleanup projects, and the amounts actually spent may be greater or less than these estimates. The aggregate range of cost estimates reflects various uncertainties inherent in many environmental cleanup activities, the large number of sites and facilities involved and the amount of third-party claims. The Company believes that most of these cost ranges will narrow as cleanup activities progress. The Company believes that its reserves are adequate, but as the scope of its obligations becomes more clearly defined, these reserves (and the associated indemnification obligations of VI and VSEA) may be modified and related charges or credits against earnings may be made.

Although any ultimate liability arising from environmental-related matters described herein could result in significant expenditures that, if aggregated and assumed to occur within a single fiscal year would be material to the Company s consolidated financial statements, the likelihood of such occurrence is considered remote. Based on information currently available to management and its best assessment of the ultimate amount and timing of environmental-related events (and assuming VI and VSEA satisfy their indemnification obligations), management believes that 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 fiscal year.

The Company evaluates its liability for environmental-related investigation and cleanup costs in light of the liability and financial strength of potentially responsible parties and insurance companies with respect to which the Company believes that it has rights to contribution, indemnity and/or reimbursement (in addition to the obligations of VI and VSEA). Claims for recovery of environmental investigation and cleanup costs already incurred, and to be incurred in the future, have been asserted against various insurance companies and other third parties. The Company receives certain cash payments in the form of settlements and judgments from defendants, its insurers and other third parties from time to time. The Company has also reached an agreement with an insurance company under which that insurance company agreed to pay a portion of the Company s past and future environmental-related expenditures. Accordingly, the Company had receivables of $2.9 million at both July 3, 2009 and September 26, 2008, which were included in Other assets in the Condensed Consolidated Balance Sheets. The Company believes that the current receivable is recoverable because it is based on a binding, written settlement agreement with a solvent and financially viable insurance company and the insurance company has in the past paid the claims that the Company has made.

***Acquisition-Related Commitments/Obligations***

When the Company acquired ACCEL in January 2007, ACCEL was involved in a contract-related lawsuit. Subsequent to the acquisition, the Company settled this lawsuit and agreed to perform certain services under a new contract for a fixed price. From January to September 2007, the Company gathered information related to the expected cost of satisfying its contractual commitments and completed its assessment as of September 28, 2007. As a result, the final purchase price allocation of ACCEL included a loss accrual related to this contingency of 28.3 million. In the third quarter of fiscal year 2009, the Company increased the cost estimate to complete its contractual commitments by 4.9 million, which was recorded in the Condensed Consolidated Statement of Earnings. 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 Condensed Consolidated Statement of Earnings in the periods these variances arise. As of July 3, 2009, the balance of the loss accrual related to this contingency was 9.0 million. The Company is currently engaged in arbitration to resolve a dispute under the new contract.

***Other Matters***

The Company is involved, from time to time, in legal proceedings, claims and government inspections or investigations, 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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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**(Unaudited)**

**10. RETIREMENT PLANS**

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| (In thousands) | July 3, 2009 | June 27, 2008 | July 3, 2009 | June 27, 2008 |
| **Defined Benefit Plans** | | | | |
| Service cost | $ 498 | $ 463 | $ 1,492 | $ 1,407 |
| Interest cost | 1,225 | 1,337 | 3,610 | 3,955 |
| Settlement gain | (448) | | (448) | (587) |
| Expected return on plan assets | (1,283) | (1,563) | (3,767) | (4,636) |
| Amortization of prior service cost | 37 | 40 | 111 | 114 |
| Recognized actuarial loss | 272 | 128 | 809 | 385 |
| Net pension benefit cost | $ 301 | $ 405 | $ 1,807 | $ 638 |
| **Post-Retirement Benefit Plans** | | | | |
| Interest cost | $ 91 | $ 91 | $ 273 | $ 274 |
| Amortization of transition amount | 123 | 123 | 369 | 370 |
| Amortization of prior service cost | 1 | 1 | 3 | 3 |
| Recognized actuarial (gain) loss | (8) | 4 | (24) | 12 |
| Net pension benefit cost | $ 207 | $ 219 | $ 621 | $ 659 |

The Company made contributions to the defined benefit plans of $3.7 million during the nine months ended July 3, 2009. The Company currently expects total contributions to the defined benefit plans for fiscal year 2009 will be approximately $4.9 million. The Company made contributions to the post-retirement benefit plans of $0.4 million during the nine months ended July 3, 2009. The Company currently expects total contributions to the post-retirement benefit plans for fiscal year 2009 will be approximately $0.6 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 16.5% for the three months ended July 3, 2009, compared to 17.5% in the same period of fiscal year 2008. For the nine months ended July 3, 2009, the Company s effective tax rate was 27.7%, compared to 27.8% in the same period of fiscal year 2008. The decrease in the Company s effective tax rate for the three-month and nine-month periods ended July 3, 2009 from the year ago periods was primarily due to a net benefit from discrete items, primarily the release of certain liabilities for uncertain tax positions under FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ), including the expiration of the statutes of limitation in various jurisdictions and the favorable resolution of several income tax audits.

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 Company adopted the provisions of FIN 48 effective as of the beginning of fiscal year 2008. The total amount of unrecognized tax benefits decreased by a significant amount during the nine-month period ended July 3, 2009, primarily as a result of the expiration of the statutes of limitation and audit settlements in various jurisdictions. However, the amount of unrecognized tax benefits has also increased as a result of positions taken during the current and prior years. It is reasonably possible that the Company s unrecognized tax benefits will decrease within the next 12 months. Unrecognized tax benefits of approximately $15.2 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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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**(Unaudited)**

**12. STOCKHOLDERS EQUITY**

***Stock Repurchase Program***

On July 24, 2007, VMS s Board of Directors approved the repurchase up to 12,000,000 shares of VMS common stock during the period beginning on July 30, 2007 through December 31, 2008. During the nine months ended July 3, 2009, the Company paid $71.5 million to repurchase 1,548,000 shares of VMS common stock, all of which were repurchased during the first quarter of fiscal year 2009. All shares that have been repurchased have been retired. The authorization expired at the end of the first quarter, with 4,342,000 shares available for repurchase. On November 17, 2008, VMS s Board of Directors authorized the repurchase of an additional 8,000,000 shares of VMS common stock from January 1, 2009 through December 31, 2009. As of July 3, 2009, no repurchase had yet been made under the November 17, 2008 authorization.

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**(Unaudited)**

***Comprehensive Earnings***

The components of comprehensive earnings are as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| **(In thousands)** | **July 3, 2009** | **June 27, 2008** | **July 3, 2009** | **June 27, 2008** |
| **Net earnings** | **$ 85,351** | **$ 74,180** | **$ 221,961** | **$ 201,022** |
| Other comprehensive income, net of tax: | | | | |
| Defined benefit pension and post-retirement benefit plans: | | | | |
| Amortization of transition obligation included in net periodic benefit cost | 76 | 75 | 227 | 225 |
| Amortization of prior service cost included in net periodic benefit cost | 33 | 36 | 99 | 103 |
| Amortization of net actuarial loss included in net periodic benefit cost | 192 | 94 | 570 | 284 |
| | 301 | 205 | 896 | 612 |
| Unrealized gain on derivatives: | | | | |
| Increases (decrease) in unrealized gain | (822) | | 4,384 | |
| Reclassification adjustments | (1,503) | | (3,590) | |
| | (2,325) | | 794 | |
| Currency translation adjustment | 3,513 | (897) | (1,478) | 5,066 |
| Reclassification of foreign currency translation resulting from the sale of Research Instruments | | | (778) | |
| | 3,513 | (897) | (2,256) | 5,066 |
| **Other comprehensive income (loss)** | **1,489** | **(692)** | **(566)** | **5,678** |
| **Total comprehensive earnings** | **$ 86,840** | **$ 73,488** | **$ 221,395** | **$ 206,700** |

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 SFAS No. 123(R), *Share-Based Payment* ( SFAS 123(R) ):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| **(In thousands, except per share amounts)** | **July 3, 2009** | **June 27, 2008** | **July 3, 2009** | **June 27, 2008** |
| Cost of revenues - Product | $ 1,106 | $ 1,087 | $ 3,232 | $ 3,029 |
| Cost of revenues - Service contracts and other | 1,066 | 978 | 3,115 | 2,581 |
| Research and development | 1,373 | 1,372 | 3,936 | 3,465 |
| Selling, general and administrative | 7,293 | 8,061 | 21,875 | 21,079 |
| Taxes on earnings | (3,574) | (3,791) | (10,324) | (10,005) |
| Net decrease in net earnings | $ 7,264 | $ 7,707 | $ 21,834 | $ 20,149 |
| Increase (decrease) on: | | | | |
| Cash flows from operating activities (1) | $ (1,353) | $ (8,224) | $ (7,375) | $ (24,273) |
| Cash flows from financing activities (1) | $ 1,353 | $ 8,224 | $ 7,375 | $ 24,273 |

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

During the three months and nine months ended July 3, 2009, total share-based compensation expense recognized in earnings before taxes was $10.8 million and $32.1 million, respectively, and the total related recognized tax benefit was $3.6 million and $10.3 million, respectively. During the three months and nine months ended June 27, 2008, total share-based compensation expense recognized in earnings before taxes was $11.5 million and $30.2 million, respectively, and the total related recognized tax benefit was $3.8 million and $10.0 million, respectively. Total share-based compensation expense capitalized as part of inventory for the three months and nine months ended July 3, 2009 was $0.4 million and $1.2 million, respectively. Total share-based compensation expense capitalized as part of inventory for the three months and nine months ended June 27, 2008 was $0.5 million and $1.6 million, respectively.

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**(Unaudited)**

The fair value of options granted and the option component of the Employee Stock Purchase Plan shares were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | July 3, 2009 (1) | June 27, 2008 | July 3, 2009 | June 27, 2008 |
| **Employee Stock Option Plans** | | | | |
| Expected term (in years) | | 4.31 | 4.57 | 4.31 |
| Risk-free interest rate | | 3.0% | 1.8% | 2.6% |
| Expected volatility | | 31.5% | 39.2% | 29.7% |
| Expected dividend | | | | |
| Weighted average fair value at grant date | | $ 14.02 | $ 13.00 | $ 15.39 |
| **Employee Stock Purchase Plan** | | | | |
| Expected term (in years) | 0.50 | 0.50 | 0.50 | 0.50 |
| Risk-free interest rate | 0.3% | 2.0% | 0.4% | 2.2% |
| Expected volatility | 37.9% | 18.3% | 47.4% | 21.6% |
| Expected dividend | | | | |
| Weighted average fair value at grant date | $ 7.79 | $ 9.60 | $ 9.70 | $ 9.39 |

(1) No options were granted in the three months ended July 3, 2009.

In February 2009, VMS s stockholders approved an amendment to the Second Amended and Restated 2005 Omnibus Stock Plan, which increased the number of shares available for grant under the plan by 4,200,000 shares.

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 (3) |
| Balance at September 26, 2008 | 3,523 | 11,957 | $ 38.79 | | |
| Authorized | 4,200 | | | | |
| Granted (1) | (2,569) | 1,070 | 37.17 | | |
| Cancelled or expired (2) | 168 | (120) | 46.37 | | |
| Exercised | | (792) | 13.52 | | |
| Balance at July 3, 2009 | 5,322 | 12,115 | $ 40.23 | 5.2 | $ 28,890 |
| Exercisable at July 3, 2009 | | 10,105 | $ 39.45 | 5.0 | $ 28,890 |

(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 the award of shares of restricted common stock, restricted stock units and deferred stock units. Awards other than stock options were counted against the shares available-for-grant limit as three shares for every one share awarded before February 16, 2007 and as 2.5 shares for every one share awarded on February 16, 2007 and thereafter.

(2) 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.

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**VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**(Unaudited)**

(3) 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 $33.50 as of July 2, 2009, that last trading date of the third quarter of fiscal year 2009, and which would have been received by the option holders had all option holders exercised and sold their options as of that date.

As of July 3, 2009, there was $19 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 September 26, 2008 | 828 | $ 49.62 |
| Granted | 600 | 37.16 |
| Vested | (209) | 52.73 |
| Cancelled or expired | (11) | 47.45 |
| Balance at July 3, 2009 | 1,208 | $ 42.91 |

As of July 3, 2009, unrecognized compensation expense totaling $41.3 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 2.5 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 | | Nine Months Ended | |
|---|---|---|---|---|
| **(In thousands, except per share amounts)** | **July 3, 2009** | **June 27, 2008** | **July 3, 2009** | **June 27, 2008** |
| Earnings from continuing operations | $ 85,351 | $ 77,056 | $ 234,288 | $ 208,183 |
| Loss from discontinued operations, net of taxes | | (2,876) | (12,327) | (7,161) |
| Net earnings | $ 85,351 | $ 74,180 | $ 221,961 | $ 201,022 |
| Basic weighted average shares outstanding | 124,237 | 124,617 | 123,961 | 124,850 |
| Dilutive effect of potential common shares | 754 | 2,448 | 937 | 2,779 |
| Diluted weighted average shares outstanding | 124,991 | 127,065 | 124,898 | 127,629 |
| Net earnings (loss) per share - basic: | | | | |
| Continuing operations | $ 0.69 | $ 0.62 | $ 1.89 | $ 1.67 |
| Discontinued operations | | (0.02) | (0.10) | (0.06) |
| Net earnings per share | $ 0.69 | $ 0.60 | $ 1.79 | $ 1.61 |
| Net earnings (loss) per share - diluted: | | | | |
| Continuing operations | $ 0.68 | $ 0.61 | $ 1.88 | $ 1.63 |
| Discontinued operations | | (0.03) | (0.10) | (0.05) |
| Net earnings per share | $ 0.68 | $ 0.58 | $ 1.78 | $ 1.58 |

Pursuant to SFAS 123(R), 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 8,325,171 shares and 6,053,749 shares at average exercise prices of $46.76 and $50.81 per share, respectively, were excluded from the computation of diluted weighted average shares outstanding for the three months ended July 3, 2009 and June 27, 2008, respectively. Stock options to purchase 8,280,231 shares and 6,053,749 shares at average exercise prices of $46.82 and $50.81 per share, respectively, were excluded from the computation of diluted weighted average shares outstanding for the nine months ended July 3, 2009 and June 27, 2008, respectively.

**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 as defined under SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. 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 | | Nine Months Ended | |
|---|---|---|---|---|
| (In millions) | July 3, 2009 | June 27, 2008 | July 3, 2009 | June 27, 2008 |
| **Revenues** | | | | |
| Oncology Systems | $ 428 | $ 408 | $ 1,271 | $ 1,189 |
| X-ray Products | 67 | 77 | 239 | 222 |
| Total reportable segments | $ 495 | $ 485 | $ 1,510 | $ 1,411 |
| Other | 15 | 22 | 62 | 66 |
| Total company | $ 510 | $ 507 | $ 1,572 | $ 1,477 |
| **Operating Earnings** | | | | |
| Oncology Systems | $ 117 | $ 94 | $ 333 | $ 280 |
| X-ray Products | 15 | 18 | 57 | 53 |
| Total reportable segments | $ 132 | $ 112 | $ 390 | $ 333 |
| Other | (14) | (2) | (14) | (2) |
| Corporate | (16) | (18) | (53) | (47) |
| Total company | $ 102 | $ 92 | $ 323 | $ 284 |

**16. DISCONTINUED OPERATIONS**

In September 2008, the Company approved a plan to sell Research Instruments, which develops, manufactures and services 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 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.

In accordance with the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company classified the assets and liabilities of Research Instruments as assets of discontinued operations and liabilities of discontinued operations in the Condensed Consolidated Balance Sheets and classified its operating results 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 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 and nine months ended July 3, 2009 were $0.2 million and $9.2 million, respectively. For the three and nine months ended June 27, 2008, total revenues of Research Instruments reported in discontinued operations were $5.4 million and $21.9 million, respectively. The Company did not recognize any income or loss from

discontinued operations for the three months ended July 3, 2009. Including the loss of $8.1 million on disposal of Research Instruments recognized in the second quarter of fiscal year 2009, the loss reported in discontinued operations for the nine months ended July 3, 2009 was $12.3 million. For the three and nine months ended June 27, 2008, the loss reported in discontinued operations was $2.9 million and $7.2 million, respectively.

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**(Unaudited)**

**17. SUBSEQUENT EVENT**

On July 14, 2009, the Company amended and restated the Amended BofA Credit Facility, providing for an unsecured revolving credit facility (the Japanese BofA Credit Facility ) that enables VMS s Japanese subsidiary ( VMS KK ) to borrow up to 2.7 billion Japanese Yen. At any time amounts are outstanding under the Japanese BofA Credit Facility, 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 BofA Credit Facility. Borrowings under the Japanese BofA Credit Facility can be used by VMS KK for refinancing certain intercompany debts, working capital, capital expenditures and other lawful corporate purposes. Borrowings under the Japanese BofA Credit Facility accrue interest based on 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 Japanese BofA Credit Facility will expire on November 10, 2010. As of August 11, 2009, the outstanding balance under the Japanese BofA Credit Facility is 2.7 billion Japanese Yen.

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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 July 3, 2009 and the related condensed consolidated statements of earnings for the three-month and nine-month periods ended July 3, 2009 and June 27, 2008 and the condensed consolidated statements of cash flows for the nine-month period ended July 3, 2009 and June 27, 2008. 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 September 26, 2008, 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 24, 2008, 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 September 26, 2008, 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

August 11, 2009

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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, or 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, or SEC, or other reasons. For this purpose, statements concerning: industry or market outlook, including growth drivers; our future orders revenues, backlog or earnings growth; future financial results; market acceptance of or transition to new products or technology such as intensity-modulated radiation therapy, or IMRT, image-guided radiation therapy, or IGRT, volumetric modulated arc therapy, or VMAT, brachytherapy, software, treatment techniques, stereotactic radiosurgery, filmless X-rays, security and inspection products, and proton therapy products; any statements using the terms believe, expect, expectation, anticipate, can, should, will, would, could, estimate, continue, grow, based on, may, intended, optimistic on-going, likely, and possible or similar 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**

In the third quarter of fiscal year 2009, we reported growth in backlog, net earnings and gross margins over the year-ago quarter, but weaker than expected revenues and net orders, particularly in our X-ray Products and Security and Inspection businesses. Excluding the discontinued scientific research instruments business, or Research Instruments, of ACCEL Instruments GmbH, or ACCEL (which subsequently changed its name to Varian Medical Systems Particle Therapy GmbH), net earnings from continuing operations per diluted share was $0.68 in the third quarter of fiscal year 2009 versus $0.61 in the third quarter of fiscal year 2008. Revenues from continuing operations in the third quarter of fiscal year 2009 were about even with revenues from continuing operations in the year-ago quarter. In the third quarter of fiscal year 2009, net orders declined by 4% over the year-ago quarter. Our backlog grew 11% from the end of the year-ago quarter. An improvement in gross margin, together with cost control initiatives, contributed to an almost two percentage point increase in operating margin over the year-ago quarter. We had $472 million of cash and cash equivalents at the end of the third quarter of fiscal year 2009.

In the second quarter of fiscal year 2009, the Company completed the sale of Research Instruments in order to focus that business exclusively on the development of our proton therapy business, now operating as Varian Particle Therapy. Accordingly, Research Instruments is classified as a discontinued operation for all periods presented and we have segregated the net assets and operating results of Research Instruments from continuing operations in our Condensed Consolidated Balance Sheets and in our Condensed Consolidated Statements of Earnings. Unless otherwise stated, the discussion in this MD&A pertains to our continuing operations. Research Instruments was previously included in the Other category.

***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 radiation therapy, fixed field IMRT, IGRT, stereotactic radiotherapy and stereotactic radiosurgery, brachytherapy and VMAT, which is a special form of IMRT. Products include linear accelerators, brachytherapy afterloaders, treatment simulation and verification equipment and accessories; as well as information management, treatment planning and image processing software.

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; improvement in 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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For the third quarter of fiscal year 2009, Oncology Systems experienced the combined effect of a recession that has shrunk capital equipment budgets, slowed decision making and made financing more expensive and time consuming; the added uncertainty created by the prospects of healthcare reform in the United States; and the uncertainty about the proposed reduction in Medicare reimbursement rates for radiotherapy and radiosurgery at freestanding clinics in the United States, which we believe represents approximately 10% of Oncology Systems business. We expect that uncertainty in North American radiation therapy capital spending will persist until there is greater clarity on healthcare reform and reimbursement rates. North American net orders decreased 9% and Asia and Europe contributed to the 8% growth in international net orders in the third quarter of fiscal year 2009 over the year-ago quarter, while the rest of the world region experienced a decline. The stronger U.S. dollar against foreign currencies compared to the year-ago period negatively impacted international net orders in the third quarter of fiscal year 2009.

In the third quarter of fiscal year 2009, Oncology Systems North American revenues remained relatively flat compared to the year-ago quarter while Oncology Systems international revenues grew by 10%, even though they were negatively affected by the strengthening of the U.S. dollar. A product mix shift toward higher margin software products, together with higher sales volume and cost control initiatives contributed to a 2.8 percentage-point improvement in Oncology Systems gross margin in the third quarter of fiscal year 2009 compared to the year ago period. As of the end of the third quarter of fiscal year 2009, we had more than 180 installations of our RapidArc™ products since we introduced these products in the second quarter of fiscal year 2008.

During the third quarter of fiscal year 2009, we acquired certain assets of IKOEmed LLC and IKOEtech LLC, collectively referred to as IKOE, which are privately-owned suppliers of software used in the planning of radiotherapy and radiosurgery treatments. The acquired software, which is being incorporated into some of our Oncology Systems products, complements our existing segmentation tools currently used to automate planning for prostate, breast, and lung treatments.

The current worldwide economic downturn is making it more difficult for our customers, our vendors and us to accurately forecast and plan future business activities. We have seen customers decision-making process further complicated and lengthened as the current worldwide economic downturn causes hospitals, clinics and research institutions to more closely scrutinize and prioritize their capital spending budgets in light of tightened capital budgets, tougher credit requirements and the general constriction in credit availability. We cannot predict the timing or duration of any economic slowdown or the timing or strength of a subsequent economic recovery, in general or specifically in the healthcare industry. If the healthcare market significantly deteriorates due to these macroeconomic effects, our business, financial condition and results of operations will likely be materially and adversely affected. Additionally, other external influences that could adversely impact our Oncology Systems business include the fluctuations in currency exchange rates, healthcare reform and changes in governmental healthcare policy now being considered by Congress or otherwise and changes in Medicare and Medicaid reimbursement rates for radiotherapy, brachytherapy and radiosurgery procedures in the United States.

The strengthening of the U.S. dollar against foreign currencies that we experienced in recent quarters, including the third quarter of fiscal year 2009, has made our pricing less competitive and may result in slower growth in our international orders and revenues. The stronger U.S. dollar compared to prior periods also may negatively affect our revenues and net orders when measured in U.S. dollars. Additionally, we have seen the purchasing cycle lengthen for some customers, which we believe results from a more complex decision-making process associated with larger dollar value transactions for more sophisticated IGRT and surgical equipment and other technical advances. Revenues are also influenced by the timing of product shipments which are tied to planned customer-requested delivery dates. These factors may result in greater fluctuation in our Oncology Systems net orders and revenues.

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

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X-ray Products revenues decreased in the third quarter of fiscal year 2009 following the inventory adjustments by several imaging equipment manufacturers in the second quarter of fiscal year 2009. A relatively modest decline in net orders in the third quarter of fiscal year 2009 over the third quarter of fiscal year 2008, as compared to the decline in net orders in the second quarter of fiscal year 2009 over the second quarter of fiscal year 2008, suggests that customer inventory adjustments may be abating and that this business segment could be nearing a return to more normal growth patterns. Compared to the year-ago quarter, net orders for x-ray tubes increased in the third quarter of fiscal year 2009 while net orders for our flat panel detectors declined as this product line, particularly in the dental and veterinary markets which have been hit hard in the recession, continued to experience the impact of customer inventory adjustments.

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 we have seen since 2008 may make it difficult for our OEM customers, our vendors and us to accurately forecast and plan future business activities. If the markets for our customers significantly deteriorate due to these macroeconomic effects, our business and results of operations may be adversely affected. The rising costs of raw materials due to increased worldwide demand which we have seen over the last two years have abated with the recent worldwide economic downturn. Global demand for such commodities has lessened and we have seen decreases in some commodity prices for our materials, which should eventually benefit our product cost structure.

***Other.*** The Other category is comprised of SIP, the Varian Particle Therapy business, and the operations of the Ginzton Technology Center, or 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 for security and inspection purposes, such as cargo screening at ports and borders and nondestructive product examination for a variety of applications. SIP also designs, manufactures, sells and services IntellX™ , an imaging product for cargo screening. 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 private parties in the casting, power, aerospace, chemical, petro-chemical and automotive industries for nondestructive product examination purposes.

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, border protection and customs revenue activities; these activities depend upon government budgets and appropriations and are subject to political change. Orders and revenues for our SIP products have been and may continue to be unpredictable as governmental agencies may place large orders with our OEM customers in a short time period and then may not place any orders for a long time period thereafter. However, as budgets are put on hold or reallocated in this recession, customers have postponed their purchasing decisions.

Our Varian Particle Therapy business develops, designs, manufactures and services products and systems for delivering proton therapy, another form of external beam radiation therapy using proton beams for the treatment of cancer. Proton therapy, as a clinical treatment modality, is still not wide-spread and the technology is still developing. 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, or CE, mark requirements, permitting us to market our proton therapy systems within the European Economic Area, or EEA. Also in the same quarter, patient treatments started on our proton therapy system installed at the Rinecker Proton Therapy Center in Munich, Germany. Proton therapy facilities, nevertheless, are large scale construction projects that can take three years or more to complete. With the cost of a multiple-gantry system in excess of $60 million and the total cost for each proton therapy center exceeding $100 million, significant customer investment and perhaps complex project financing will be required. Consequently, the customers decision-making cycle is very long and orders for proton therapy systems generally involve many contingencies. We will not book orders for proton therapy systems until non-perfunctory contingencies are eliminated under our current practice. We are continuing negotiations and are making progress with several customers both inside and outside the United States. In the short term, we are hopeful of receiving a first order for our proton therapy system, and do not expect to start generating significant proton therapy systems revenues. Given the heavy reliance of customers of this business on credit and large-scale project financing, this business is the most vulnerable to the general worldwide economic downturn and contraction in the credit and public bond markets.

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

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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 third quarter of fiscal year 2009, net orders and revenues in the Other category decreased 69% and 36%, respectively, over the year-ago quarter due exclusively to declines in SIP net orders and revenues. Government postponements of proposals for port and border security systems and cautious practices among cargo screening systems integrators who incorporate our products contributed to the sharp declines in SIP net orders.

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 September 26, 2008, or the 2008 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, or 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. 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 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.

***Share-based Compensation Expense***

Effective October 1, 2005, we adopted Statement of Financial Accounting Standards, or SFAS, No. 123 (revised 2004), *Share-Based Payment,* or SFAS 123(R), using the modified prospective transition method. We have valued our share-based payment awards granted beginning in fiscal year 2006 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. Upon the adoption of SFAS 123(R), we determined the expected term of stock options based on the demographic grouping of employees and retirement eligibility. Upon the adoption of SFAS 123(R), we used a combination of historical and implied volatility, or blended volatility, in 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 cannot 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 granted. Therefore, we believe a combination of the historical volatility over the expected lives of the stock options granted by us and the implied volatility of six-month exchange-traded options best reflects

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the expected volatility of VMS common stock going forward. 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 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.

***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 in 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. Also, revenues related our proton therapy commissioning service contract are recognized under the completed contract method. 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.

***Allowance for Doubtful Accounts***

We evaluate the creditworthiness of our customers prior to authorizing shipment for all major sale transactions. Our customary payment terms 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 affected negatively.

***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.

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***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.

We evaluate goodwill and purchased assets with indefinite lives for impairment at least annually in accordance with SFAS 142 *Goodwill and Other Intangible Assets*. 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 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. 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 regulating the handling, storage, transport and disposal of hazardous substances that do or may create increased costs for some of our operations. Environmental remediation liabilities are recorded when environmental assessments and/or remediation efforts are probable and the costs of these assessments or remediation efforts can be reasonably estimated, in accordance with SFAS No. 5, *Accounting for Contingencies,* and the American Institute of Certified Public Accountants, Statement of Position 96-1, *Environmental Remediation Liabilities.* The accrued environmental costs represent our best estimate as to the total costs of remediation and the time period over which these costs will be incurred. On a quarterly basis, we review these accrued balances. If we were required to accrue additional environmental remediation costs in the future, it would negatively impact our operating results.

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***Defined Benefit and Post-Retirement Benefit Plans***

We sponsor six 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 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 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 subjective factors, 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 pension 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 of 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.

***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. SFAS No. 157, *Fair Value Measurements*, or SFAS 157, 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, the London Interbank Offered Rate, or 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 less than twelve 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.

Effective as of the beginning of fiscal year 2008, we adopted the provisions of Financial Accounting Standards Board, or FASB, Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*, or FIN 48. FIN 48 contains a two-step approach to recognizing, derecognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109, *Accounting for Income Taxes*. 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

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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 to include interest and penalties related to unrecognized tax benefits within the provision for taxes on earnings did not change as a result of the adoption of FIN 48.

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.

**Results of Operations**

***Fiscal Year***

Our fiscal year is the 52- or 53-week period ending on the Friday nearest September 30. Fiscal year 2009 is the 53-week period ending October 2, 2009, and fiscal year 2008 was the 52-week period ended on September 26, 2008. The fiscal quarters ended July 3, 2009 and June 27, 2008 were both 13-week periods.

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**Discussion of Financial Data for the Third Quarter and First Nine Months of Fiscal Year 2009 Compared to the Third Quarter and First Nine Months of Fiscal Year 2008**

***Total Revenues***

| Revenues by sales classification | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| (Dollars in millions) | July 3, 2009 | June 27, 2008 | Percent Change | July 3, 2009 | June 27, 2008 | Percent Change |
| Product | $ 396.8 | $ 410.1 | (3)% | $ 1,248.3 | $ 1,203.2 | 4% |
| Service Contracts and Other | 113.0 | 97.3 | 16% | 323.8 | 273.8 | 18% |
| Total Revenues | $ 509.8 | $ 507.4 | 0% | $ 1,572.1 | $ 1,477.0 | 6% |
| *Product as a percentage of total revenues* | *78%* | *81%* | | *79%* | *81%* | |
| *Service Contracts and Other as a percentage of total revenues* | *22%* | *19%* | | *21%* | *19%* | |
| **Revenues by region** | | | | | | |
| North America | $ 248.9 | $ 256.3 | (3)% | $ 802.0 | $ 697.0 | 15% |
| Europe | 143.6 | 139.0 | 3% | 420.1 | 451.5 | (7)% |
| Asia | 98.6 | 85.4 | 15% | 303.3 | 268.6 | 13% |
| Rest of world | 18.7 | 26.7 | (30)% | 46.7 | 59.9 | (22)% |
| Total International (1) | 260.9 | 251.1 | 4% | 770.1 | 780.0 | (1)% |
| Total | $ 509.8 | $ 507.4 | 0% | $ 1,572.1 | $ 1,477.0 | 6% |
| *North America as a percentage of total revenues* | *49%* | *51%* | | *51%* | *47%* | |
| *International as a percentage of total revenues* | *51%* | *49%* | | *49%* | *53%* | |

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

For the third quarter of fiscal year 2009, the growth in Oncology Systems total revenues was offset by the declines in X-ray Products and SIP total revenues. Product revenues for the third quarter of fiscal year 2009 decreased 3% from the year-ago period as decreases in X-ray Products and SIP product revenues more than offset an increase in Oncology Systems product revenues. Total revenues, as well as product revenues, increased in the first nine months of fiscal year 2009 over the year-ago period primarily due to the revenue growth in both of our business segments partially offset by a decline in SIP revenues. Oncology Systems service contracts revenues were the primary contributor to the growth in service contracts and other revenues for the quarter and for the nine-month period.

North American revenues for the third quarter of fiscal year 2009 decreased by 3% over the year-ago quarter primarily due to a decrease in X-ray Products revenues and, to a lesser extent, a decrease in SIP revenues which offset a slight increase in Oncology Systems revenues. For the first nine months of fiscal year 2009, North American revenues increased 15% over the first nine months of fiscal year 2008, primarily driven by the growth in Oncology Systems revenues and, to a lesser extent, the growth in SIP and X-ray Products revenues.

Total international revenues increased by 4% in the third quarter of fiscal year 2009 over the year-ago quarter, which is attributable to the increase in Oncology Systems international revenues, which was partially offset by the declines in X-ray Products and SIP international revenues. For the first nine months of fiscal year 2009, the growth in X-ray Products international revenues over the year-ago period was more than offset by the decreases in SIP and Oncology Systems international revenues. The stronger U.S. dollar against foreign currencies compared to the year-ago period negatively affected our international revenues for the quarter and for the nine-month period when measured in U.S. dollars.

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***Oncology Systems Revenues***

| Revenues by sales classification | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| (Dollars in millions) | July 3, 2009 | June 27, 2008 | Percent Change | July 3, 2009 | June 27, 2008 | Percent Change |
| Product | $ 318.2 | $ 312.0 | 2% | $ 956.0 | $ 922.5 | 4% |
| Service Contracts (1) | 110.0 | 95.7 | 15% | 315.0 | 266.7 | 18% |
| Total Oncology Systems revenues | $ 428.2 | $ 407.7 | 5% | $ 1,271.0 | $ 1,189.2 | 7% |
| *Product as a percentage of total Oncology Systems revenues* | *74%* | *77%* | | *75%* | *78%* | |
| *Service Contracts as a percentage of Oncology Systems revenues* | *26%* | *23%* | | *25%* | *22%* | |
| *Oncology Systems revenues as a percentage of total revenues* | *84%* | *81%* | | *81%* | *81%* | |

(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.

The increases in Oncology Systems product revenues for the third quarter and the first nine months of fiscal year 2009 over the respective year-ago periods were primarily driven by an increase in revenues from sales of our software products (including our RapidArc products), partially offset by a decline in revenues from sales of our high linear accelerators. The increases in service contracts revenues in the third quarter and the first nine months of fiscal year 2009 over the year-ago periods were primarily driven by increased customer adoption of service contracts, as the sophistication of our products and the installed base of our software products increased. In addition, the stronger U.S. dollar against foreign currencies compared to that of the year-ago period negatively affected our international revenues the quarter and for the nine-month period when measured in U.S. dollars.

| Revenues by region | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| (Dollars in millions) | July 3, 2009 | June 27, 2008 | Percent Change | July 3, 2009 | June 27, 2008 | Percent Change |
| North America | $ 224.1 | $ 222.6 | 1% | $ 698.6 | $ 600.7 | 16% |
| Europe | 127.0 | 113.9 | 11% | 353.5 | 375.9 | (6)% |
| Asia | 60.8 | 46.5 | 31% | 178.9 | 159.0 | 13% |
| Rest of world | 16.3 | 24.7 | (34)% | 40.0 | 53.6 | (25)% |
| Total International | 204.1 | 185.1 | 10% | 572.4 | 588.5 | (3)% |
| Total Oncology Systems Revenues | $ 428.2 | $ 407.7 | 5% | $ 1,271.0 | $ 1,189.2 | 7% |
| *North America as a percentage of Oncology Systems revenues* | *52%* | *55%* | | *55%* | *51%* | |
| *International as a percentage of Oncology Systems revenues* | *48%* | *45%* | | *45%* | *49%* | |

For the third quarter of fiscal year 2009, North American revenues remained essentially flat compared to the third quarter of fiscal year 2008, while international revenues grew by 10% in the same period. In North America, an increase in revenues from our service contracts and from sales of our software products (including our RapidArc products) were significantly offset by a decline in sales of our high energy linear accelerators. In the international region, the revenue growth was attributed to an increase in sales of our software products (including our RapidArc products) in all international regions and an increase in our service contracts in Asia and Europe. The stronger U.S. dollar against foreign currencies compared to the year-ago period negatively affected our international revenues when measured in U.S. dollars.

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For the first nine months of fiscal year 2009, North American revenues grew by 16% while international revenues declined by 3% over the year-ago period. The increase in North American revenues was primarily due to an increase in product revenues from sales of our software products (including our RapidArc products) and our high energy linear accelerators, as well as an increase in service contract revenues. International revenues decreased in the first nine months of fiscal year 2009 primarily due to a decrease in product revenues from sales of our high energy accelerators in all international regions, partially offset by increased product sales of our software products (including our RapidArc products) in all international regions and from increased service contract revenues in Asia and Europe. The stronger U.S. dollar against foreign currencies compared to the year-ago period also negatively 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 is consistent with the net order patterns discussed more fully under Net Orders. Oncology Systems revenues also continued to be influenced by the timing of product shipments in accordance with planned customer-requested delivery dates, and are being impacted by the effects of the recession, uncertainty created by the prospects of healthcare reform in the United States, and uncertainty regarding Medicare reimbursement rates for radiotherapy and radiosurgery at freestanding clinics in the United States.

***X-ray Products Revenues***

| **Revenues by region** | **Three Months Ended** | | | **Nine Months Ended** | | |
|---|---|---|---|---|---|---|
| **(Dollars in millions)** | **July 3, 2009** | **June 27, 2008** | **Percent Change** | **July 3, 2009** | **June 27, 2008** | **Percent Change** |
| North America | $ 19.5 | $ 27.2 | (28)% | $ 78.4 | $ 77.4 | 1% |
| Europe | 9.6 | 11.3 | (16)% | 34.4 | 33.1 | 4% |
| Asia | 35.9 | 36.7 | (3)% | 119.7 | 105.3 | 14% |
| Rest of world | 2.2 | 2.0 | 19% | 6.6 | 6.3 | 6% |
| Total International | 47.7 | 50.0 | (5)% | 160.7 | 144.7 | 11% |
| Total X-ray Products Revenues | $ 67.2 | $ 77.2 | (13)% | $ 239.1 | $ 222.1 | 8% |
| *North America as a percentage of X-ray Products revenues* | *29%* | *35%* | | *33%* | *35%* | |
| *International as a percentage of X-ray Products revenues* | *71%* | *65%* | | *67%* | *65%* | |
| *X-ray Products revenues as a percentage of total revenues* | *13%* | *15%* | | *15%* | *15%* | |

X-ray Products revenues decreased by 13% in the third quarter of fiscal year 2009 over the third quarter of fiscal year 2008 following the inventory adjustments by several imaging equipment manufacturers who decreased their orders in the second quarter of fiscal year 2009. Decreases in sales of our flat panel detectors and our x-ray tubes contributed to the revenue decreases in both the North American and international regions.

For the first nine months of fiscal year 2009, X-ray Products revenue grew 8% over the year-ago period due primarily to the growth in the international region while North American revenues remained essentially flat. The increase in international revenues in the first nine months of fiscal year 2009 was primarily due to increased revenues from sales of our x-ray tubes in Asia and increased revenues from sales of our flat panel detectors in Europe and Asia compared to the first nine months of fiscal year 2008. In North America, the growth in revenues from sales of our x-ray tubes was significantly offset by the revenue decrease from sales of our flat panel detectors.

We sell our x-ray products to a limited number of OEM customers for incorporation into diagnostic imaging systems. Many of our OEM customers for x-ray tube products are also our competitors. The loss of, or reduction in purchasing volume by, one or more of these customers would have a material adverse effect on our X-ray Products business. 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. The current market for new X-ray imaging equipment appears to be 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 these macroeconomic effects, our X-ray Products business may be adversely affected.

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***Other Revenues***

| Revenues by sales classification | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| (Dollars in millions) | July 3, 2009 | June 27, 2008 | Percent Change | July 3, 2009 | June 27, 2008 | Percent Change |
| Product | $ 11.4 | $ 20.8 | (45)% | $ 53.3 | $ 58.5 | (9)% |
| Service Contracts and Other | 3.0 | 1.7 | 83% | 8.7 | 7.2 | 22% |
| Total Other revenues | $ 14.4 | $ 22.5 | (36)% | $ 62.0 | $ 65.7 | (6)% |
| *Other revenues as a percentage of total revenues* | *3%* | *4%* | | *4%* | *4%* | |

Revenues in our Other category, which is comprised of SIP, Varian Particle Therapy and GTC, decreased in the third quarter and the first nine months of fiscal year 2009 over the respective prior year periods primarily due to declines in product revenues in our SIP business as a result of customer requested delays in delivery.

***Gross Margin***

| | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| (Dollars in millions) | July 3, 2009 | June 27, 2008 | Percent Change | July 3, 2009 | June 27, 2008 | Percent Change |
| **Dollar by segment** | | | | | | |
| Oncology Systems | $ 194.2 | $ 173.8 | 12% | 563.7 | $ 503.8 | 12% |
| X-ray Products | 24.9 | 31.1 | (20)% | 94.3 | 85.9 | 10% |
| Other | (2.9) | 7.4 | (138)% | 17.6 | 25.3 | (30)% |
| Gross margin | $ 216.2 | $ 212.3 | 2% | $ 675.6 | $ 615.0 | 10% |
| **Percentage by segment** | | | | | | |
| *Oncology Systems* | *45.4%* | *42.6%* | | *44.4%* | *42.4%* | |
| *X-ray Products* | *37.1%* | *40.3%* | | *39.5%* | *38.7%* | |
| *Total Company* | *42.4%* | *41.8%* | | *43.0%* | *41.6%* | |

The increase in gross margin for the third quarter of fiscal year 2009 over the third quarter of fiscal year 2008 was primarily due to the improvement in Oncology System gross margin, which was partially offset by decreases in gross margins in our X-way Products segment and our businesses in the Other category. For the first nine months of fiscal year 2009, both of our business segments and SIP contributed to the improvement in gross margin while Varian Particle Therapy gross margin decreased. The decrease in Varian Particle Therapy gross margin for the quarter and for the nine-month period was due to an increase in estimated costs to complete its contractual commitments in connection with the acquisition of ACCEL. See Acquisition-Related Commitments/Obligations for more information.

Improvement in both product gross margin and service contract gross margin contributed to the increase in Oncology Systems gross margin in the third quarter and the first nine months of fiscal year 2009 over the respective year-ago periods. For the third quarter of fiscal year 2009, product gross margin increased to 44.1% from 42.2% in the same quarter of fiscal year 2008. For the first nine months of fiscal year 2009, product gross margin increased to 43.4% from 41.1% in the same period of fiscal year 2008. The improvement in product gross margin for the quarter and for the nine-month period was primarily due to product mix shift toward higher margin software products. Service contract gross margin increased to 49.0% in the third quarter of fiscal year 2009 from 44.2% in the year-ago quarter. Service contract gross margin increased to 47.3% in the first nine months of fiscal year 2009 from 46.7% in the first nine months of fiscal year 2008. The improvement in service contract gross margin for the quarter and for the first nine months of the fiscal year was primarily due to cost control initiatives and higher volume in the fiscal year 2009 periods.

X-ray Products gross margin decreased in the third quarter of fiscal year 2009 over the year-ago quarter primarily due to lower overall sales volume as well as increased material costs for our flat panel detectors. For the first nine months of fiscal year 2009, X-ray Products gross margin

improved over the year-ago period primarily due to product mix shift toward higher margin x-ray tube products and a decrease in quality costs.

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***Research and Development***

| (Dollars in millions) | Three Months Ended July 3, 2009 | Three Months Ended June 27, 2008 | Percent Change | Nine Months Ended July 3, 2009 | Nine Months Ended June 27, 2008 | Percent Change |
|---|---|---|---|---|---|---|
| Research and development | $ 35.3 | $ 35.7 | (1)% | $ 109.3 | $ 96.5 | 13% |
| *As a percentage of total revenues* | *6.9%* | *7.0%* | | *7.0%* | *6.5%* | |

The $0.4 million decrease in research and development expense for the third quarter of fiscal year 2009 over the third quarter of fiscal year 2008 was driven by decreased expenses of $1.9 million in X-ray Products, which was partially offset by a $1.5 million increase in the Other category. Oncology Systems research and development expense for the third quarter of fiscal year 2009 remained flat compared to the year-ago quarter. The $1.9 million decrease in X-ray Products research and development expenses was primarily due to reduced expenses related to the development projects for both x-ray tubes and flat panel products. The $1.5 million increase in Other category was mainly due to higher expense for development projects in Varian Particle Therapy and SIP.

The $12.8 million increase in research and development expense for the first nine months of fiscal year 2009 over the first nine months of fiscal year 2008 was driven by increased expenses of $5.1 million in Oncology Systems, $4.8 million in the Other category and $2.9 million in X-ray Products. The $5.1 million increase in Oncology Systems was attributable primarily to an increase in employee headcount, material costs and consulting expenses for product development, although these expenses were partially offset by a favorable currency translation impact, due to the relatively strong U.S. dollar against foreign currencies, when foreign currency denominated research and development expenses for Oncology Systems were translated into U.S. dollars. The $4.8 million increase in the Other category was primarily due to higher expense for development projects in Varian Particle Therapy and SIP. The $2.9 million increase in X-ray Products was mainly for development projects for both x-ray tubes and flat panel products.

***Selling, General and Administrative***

| (Dollars in millions) | Three Months Ended July 3, 2009 | Three Months Ended June 27, 2008 | Percent Change | Nine Months Ended July 3, 2009 | Nine Months Ended June 27, 2008 | Percent Change |
|---|---|---|---|---|---|---|
| Selling, general and administrative | $ 78.4 | $ 84.5 | (7)% | $ 242.8 | $ 234.7 | 3% |
| *As a percentage of total revenues* | *15.4%* | *16.7%* | | *15.4%* | *15.9%* | |

The $6.1 million decrease in selling, general and administrative expenses for the third quarter of fiscal year 2009 compared to the same period in fiscal year 2008 was primarily attributable to: (a) a $4.6 million decrease in employee-related costs primarily related to reduced accrued bonuses; (b) a gain of $1.8 million in the third quarter of fiscal year 2009, compared to a loss of $0.4 million in the year-ago quarter, for hedging balance sheet exposures from our various foreign subsidiaries and business units; and (c) favorable foreign currency impact of $2.0 million as the foreign currency denominated selling, general and administrative expenses of our foreign operations are translated into stronger U.S. dollars. These items were partially offset by a loss of $2.3 million, versus a gain of $1.0 million in the year-ago quarter, recognized on the equity investment in dpiX Holding LLC.

The $8.1 million increase in selling, general and administrative expenses for the first nine months of fiscal year 2009 compared to the same period in fiscal year 2008 was primarily attributable to: (a) a $5.1 million net increase in employee-related costs due to an increase in headcount to support our growing business activities which was partially offset by a reduction in accrued bonuses; (b) $3.9 million increase in operating expenses associated with required information technology infrastructure improvements to support our growing business activities; (c) a $3.1 million increase in depreciation expenses for our enterprise resource planning system, which was placed in service in the second quarter of fiscal year 2009; and (d) a loss of $2.3 million in the current period, compared to a gain of $0.3 million in the year-ago period, recognized on the equity investment in dpiX Holding LLC. These items were partially offset by favorable foreign currency impact of $5.0 million as the foreign currency denominated selling, general and administrative expenses of our foreign operations are translated into stronger U.S. dollars.

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***Interest Income (Expense), Net***

| (Dollars in millions) | Three Months Ended July 3, 2009 | Three Months Ended June 27, 2008 | Three Months Ended Percent Change | Nine Months Ended July 3, 2009 | Nine Months Ended June 27, 2008 | Nine Months Ended Percent Change |
|---|---|---|---|---|---|---|
| Interest income (expense), net | $ (0.2) | $ 1.3 | (118)% | $ 0.8 | $ 4.4 | (83)% |

The decrease in interest income (expense), net, in the third quarter and the first nine months of fiscal year 2009, compared to the same periods in fiscal year 2008, was attributable to the lower average interest rates earned on our cash and cash equivalents.

***Taxes on Earnings***

| | Three Months Ended July 3, 2009 | Three Months Ended June 27, 2008 | Three Months Ended Percent Change | Nine Months Ended July 3, 2009 | Nine Months Ended June 27, 2008 | Nine Months Ended Percent Change |
|---|---|---|---|---|---|---|
| Effective tax rate | 16.5% | 17.5% | (1.0)% | 27.7% | 27.8% | (0.1)% |

Our effective tax rate was 16.5% for the three months ended July 3, 2009, compared to 17.5% in the same period of fiscal year 2008. For the nine months ended July 3, 2009, our effective tax rate was 27.7%, compared to 27.8% in the same period of fiscal year 2008. The decrease in our effective tax rate for the three-month and nine-month periods ended July 3, 2009 from the year ago periods was primarily due to a net benefit from discrete items, primarily the release of certain FIN 48 liabilities for uncertain tax positions, including the expiration of the statutes of limitation in various jurisdictions and the favorable resolution of several income tax audits.

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, changes in the valuation of our deferred tax assets or liabilities, and changes in tax laws or interpretations of those laws. We also expect that our effective tax rate may experience increased fluctuation from period to period under the provisions of FIN 48.

***Net Earnings Per Diluted Share***

| | Three Months Ended July 3, 2009 | Three Months Ended June 27, 2008 | Three Months Ended Percent Change | Nine Months Ended July 3, 2009 | Nine Months Ended June 27, 2008 | Nine Months Ended Percent Change |
|---|---|---|---|---|---|---|
| Net earnings per diluted share | $ 0.68 | $ 0.61 | 11% | $ 1.88 | $ 1.63 | 15% |

The increase in earnings per diluted share in the third quarter of fiscal year 2009 over the same quarter in fiscal year 2008 resulted from (i) a reduction in selling, general and administrative expenses due to cost control initiatives; (ii) an improvement in gross margin; (iii) a lower effective tax rate and (iv) a reduction in the number of diluted shares of common stock due to stock repurchases in the prior quarters and lower stock prices compared to the year-ago periods.

The increase in earnings per diluted share in the first nine months of fiscal year 2009 over the same periods in fiscal year 2008 resulted from (i) an increase in total revenues; (ii) an improvement in gross margin and (iii) a reduction in the number of diluted shares of common stock due to stock repurchases in the prior quarters and lower stock prices compared to the year-ago periods.

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*Net Orders*

| Total Net Orders (by segment and region) | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| (Dollars in millions) | July 3, 2009 | June 27, 2008 | Percent Change | July 3, 2009 | June 27, 2008 | Percent Change |
| **Oncology Systems:** | | | | | | |
| North America | $ 219.2 | $ 239.8 | (9)% | $ 666.5 | $ 665.3 | 0% |
| Total International | 240.1 | 221.6 | 8% | 654.6 | 594.9 | 10% |
| Total Oncology Systems | $ 459.3 | $ 461.4 | (0)% | $ 1,321.1 | $ 1,260.2 | 5% |
| **X-ray Products:** | | | | | | |
| North America | $ 31.7 | $ 40.3 | (21)% | $ 85.3 | $ 104.7 | (19)% |
| Total International | 50.5 | 44.2 | 14% | 156.8 | 137.9 | 14% |
| Total X-ray Products | $ 82.2 | $ 84.5 | (3)% | $ 242.1 | $ 242.6 | (0)% |
| **Other:** | $ 8.3 | $ 26.5 | (69)% | $ 62.1 | $ 74.0 | (16)% |
| **Total Net Orders:** | $ 549.8 | $ 572.4 | (4)% | $ 1,625.3 | $ 1,576.8 | 3% |

Compared to the third quarter of fiscal year 2008, Oncology Systems net orders were flat in the third quarter of fiscal year 2009, while SIP and X-ray Products net orders decreased. For the first nine months of fiscal year 2009, the net order growth in Oncology Systems was partially offset by the net order decline in SIP over the year-ago period. X-ray Products net orders were flat for the first nine months of fiscal year 2009 compared to the year-ago period.

In the third quarter of fiscal year 2009, the growth in Oncology Systems international net orders were offset by the decline in North American net orders. The growth in Oncology Systems international net orders in the third quarter of fiscal year 2009 over the year-ago quarter was primarily due to increased demand for our service contracts in all international regions, as well as increased demand for our software products in Asia and the rest of the world region and increased demand for our PortalVision imaging systems in Europe. When measured in constant currency, international net orders grew 16% in the third quarter of fiscal year 2009 over the year-ago quarter. Asia and Europe contributed to the growth in international net orders in the third quarter of fiscal year 2009 over the year-ago quarter, while the rest of the world region experienced a decline. The decline in North American net orders in the third quarter of fiscal year 2009 over the prior year quarter was primarily due to the decrease in demand for our high energy linear accelerators and our accessory products that enable IGRT (including our OBI) as hospitals and clinics tightened capital budgets, lengthened decision cycles and, in some cases, postponed decisions in reaction to the recessionary environment, the uncertainty created by the prospects of healthcare reform and the uncertainty about the proposed reduction in Medicare reimbursement rates for radiotherapy and radiosurgery at freestanding clinics.

For the first nine months of fiscal year 2009, Oncology Systems international net orders grew 10% over the year-ago period while North American net orders were flat. Growth in our service contracts and growth in demand for our software products in all international regions contributed to the year-to-date growth in international net orders. These increases were partially offset by a decrease in demand for linear accelerators in the rest of the world region. When measured in constant currency, international net orders grew 16% in the first nine months of fiscal year 2009 over the year-ago period. Asia and Europe contributed to the growth in international net orders in the first nine months of fiscal year 2009 over the year-ago period, while the rest of the world region experienced a decline. In North America, the increase in demand for our service contracts and our software products were offset by the decrease in demand for our high energy linear accelerators for nine-month period as hospitals and clinics experienced the combined effect of a recession, uncertainty created by the prospects of healthcare reform and uncertainty about the proposed reduction in Medicare reimbursement rates for radiotherapy and radiosurgery at freestanding clinics.

The trailing twelve months growth in net orders for Oncology Systems for the last three fiscal quarters were: 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; and a 13% total increase, with a 12% increase in North America and a 14% increase for international regions, as of January 2, 2009. Consistent with the historical pattern, we expect that Oncology Systems net orders will continue to experience regional fluctuations.

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Compared to a 17% decline in the second quarter of fiscal year 2009 versus the same quarter in the previous year, X-ray Products net orders decreased 3% in the third quarter of fiscal year 2009 over the year-ago quarter, primarily due to a decrease in net orders for our flat panel detectors, partially offset by an increase in net orders for our x-ray tubes. The flat panel detector product line, particularly in the dental and veterinary markets which have been hit hard in the recession, continued to experience the impact of customer inventory adjustments in the third quarter of fiscal year 2009. For the first nine months of fiscal year 2009, X-ray Products remained flat over the first nine months of fiscal year 2008. The decline in net orders for our x-ray tubes was significantly offset by an increase in net orders for our flat panel detectors between the nine-month periods.

The decrease in net orders in the Other category for the third quarter and the first nine months of fiscal year 2009 over the same periods in fiscal year 2008 was primarily due to the decrease in SIP net orders. The decline in SIP business largely stemmed from government postponements of several large proposals for port and border security systems and cautious practices among cargo screening system integrators who incorporate our products. As previously stated, orders for our SIP products may be unpredictable as governmental agencies may place large orders with our OEM customers in a short period and then may not place any orders for a long time thereafter. However, as budgets are put on hold or reallocated in this recession, customers have postponed their purchasing decisions.

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 big ticket 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 added uncertainty created by the prospects of healthcare reform in the United States and uncertainty about the proposed reduction in Medicare reimbursement rates for radiotherapy and radiosurgery at freestanding clinics in the United States. The timing of sales and 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. The sales and revenue recognition cycles for some types of orders, such as upgrades (*i.e.,* the addition of new features or accessories to existing equipment) are usually shorter than for new equipment orders. Thus, orders in any quarter or period may not be directly correlated to the level of sales or revenues in any particular future quarter or period. 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 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. In accordance with the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, Research Instruments was classified as a discontinued operation. Accordingly, we have segregated the net assets and operating results of Research Instruments from continuing operations in our Condensed Consolidated Balance Sheets and 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 $0.2 million and $5.4 million for the third quarter of fiscal years 2009 and 2008, respectively. For the nine months of fiscal year 2009, revenues from Research Instruments were $9.2 million, compared to revenues of $21.9 million in the nine months of fiscal year 2008. The Company had no income or loss from Research Instruments in the third quarter of fiscal year 2009. Net loss from Research Instruments was $2.9 million in the third quarter of fiscal year 2008. Net loss from Research Instruments was $12.3 million in the first nine months of fiscal year 2009, compared to a net loss of $7.2 million in the first nine months of fiscal year 2008. Net loss for the nine months of fiscal year 2009 included a loss on the disposal of Research Instruments of $8.1 million. See Note 16, Discontinued Operations to the Condensed Consolidated Financial Statements for a detailed discussion.

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***Backlog***

At July 3, 2009, our backlog was $1.9 billion, which is an increase of 11% over the backlog at June 27, 2008. With respect to our Oncology Systems segment, our backlog at July 3, 2009 increased 11% over the backlog at June 27, 2008, which reflects a 9% increase for North America and a 16% 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 include operations, borrowings, stock option exercises and employee stock purchases 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.

***Cash and Cash Equivalents***

The following table summarizes our cash and cash equivalents:

| (In millions) | July 3, 2009 | September 26, 2008 | Increase/ (Decrease) |
|---|---|---|---|
| Cash and cash equivalents | $ 472 | $ 397 | $ 75 |

Our cash and cash equivalents increased $75 million from $397 million at September 26, 2008 to $472 million at July 3, 2009. The increase in cash and cash equivalents in the first nine months of fiscal year 2009 was due primarily to: $189 million of cash generated from operating activities, $17 million of cash provided by stock option exercises and employee stock purchases; and $7 million of cash provided by the excess tax benefits from share-based compensation. These increases were partially offset by $72 million used for the repurchase of VMS common stock; $48 million of capital expenditures; $8 million used for the repayment of bank borrowings; $6 million used for the net loan advance to dpiX LLC, or dpiX, $3 million used for a business acquisition and $3 million used to satisfy employee tax withholding obligations when employee tendered VMS common stock in payment when their restricted common stock vested. In addition, exchange rate changes in the first nine months of fiscal year 2009 increased cash and cash equivalents by $7 million.

At July 3, 2009, we had approximately $25 million, or 5%, of total cash and cash equivalents in the United States. Approximately $447 million, or 95%, 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 July 3, 2009, 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 credit facilities to meet our cash needs in the United States from time to time and expect to continue to use our existing credit facility in the future for these purposes. Borrowings under our existing credit facility may be used for working capital, capital expenditures, acquisitions and other lawful corporate purposes.

***Cash Flows***

| | Nine Months Ended | |
|---|---|---|
| (In millions) | July 3, 2009 | June 27, 2008 |
| Net cash flow provided by (used in): | | |
| Operating activities | $ 189 | $ 290 |
| Investing activities | (63) | (59) |
| Financing activities | (58) | (72) |
| Effects of exchange rate changes on cash and cash equivalents | 7 | (16) |
| Net increase in cash and cash equivalents | $ 75 | $ 143 |

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Our primary cash inflows and outflows for the first nine months of fiscal year 2009, as compared to the first nine months of fiscal year 2008, were as follows:

In the first nine months of fiscal year 2009, we generated net cash from operating activities of $189 million, compared to $290 million for the first nine months of fiscal year 2008.

The $101 million decrease in net cash from operating activities during the first nine months of fiscal year 2009 compared to the year-ago period was driven primarily by a net change of $133 million in operating assets and liabilities (working capital items), partially offset by an increase of $21 million in net earnings and an increase in non-cash items of $11 million.

The major contributors to the net change in working capital items in the first nine months of fiscal year 2009 were inventories, advance payments from customers and other long-term liabilities as follows:

Inventories increased by $76 million due to anticipated customer demand for products in the fourth quarter of fiscal year 2009; purchases of inventory items with long lead times for our new products and for our emerging business; and weaker than expected revenues in the third quarter of fiscal year 2009.

Advance payments from customers increased by $45 million due to timing of down payments received.

Other long-term liabilities decreased by $23 million primarily due to a decrease in long-term income taxes payable as a result of the expiration of the statutes of limitation in various jurisdictions and the favorable resolution of several income tax audits.

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 of tax and other payments. For additional discussion, please refer to the Risk Factors in Item 1A.

We used $63 million for investing activities in the first nine months of fiscal year 2009, compared to $59 million used in the first nine months of fiscal year 2008. Cash used for purchases of property, plant and equipment was $48 million for the first nine months of fiscal year 2009 and $59 million for the first nine months of fiscal year 2008. In the first nine months of fiscal year 2009, we made an additional net loan advance of $6 million to dpiX.

Financing activities used net cash of $58 million in the first nine months of fiscal year 2009 compared to $72 million in the first nine months of fiscal year 2008. During the first nine months of fiscal year 2009, we used $72 million to repurchase shares of VMS common stock, $8 million to repay bank borrowings and $3 million to satisfy employee tax withholding obligations when employees tendered VMS common stock in payment when their restricted common stock vested. Partially offsetting these uses were proceeds of $17 million from employee stock option exercises and employee stock purchases, and $7 million in excess tax benefits from share-based compensation. In the first nine months of fiscal year 2008, we used $176 million to repurchase shares of VMS common stock and $9 million for the repayment of bank borrowings. These uses were partially offset by $63 million received from employee stock option exercises and employee stock purchases, $26 million for net borrowing under our credit facility and $24 million in excess tax benefits from share-based compensation.

We expect our capital expenditures (which typically represent expenditures for construction and/or purchases of facilities; manufacturing equipment; office equipment; furniture and fixtures; and capitalized costs related to the implementation of software applications) will be approximately 3% of revenues in fiscal year 2009.

We have a $150 million credit facility with Bank of America, N.A., or BofA, which was amended and restated as of November 10, 2008. This credit facility, as amended and restated, is referred to as the Amended BofA Credit Facility. 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 July 3, 2009, we have 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. Unless it is extended by mutual agreement, the Amended BofA Credit Facility will expire on November 10, 2011. Borrowings under the Amended BofA Credit Facility 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, or 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

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advances based on the LIBOR rate. Interest rates on advances based on the base rate are adjustable daily. As of July 3, 2009, there was no outstanding balance under the Amended BofA Credit Facility. 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 July 3, 2009, we were in compliance with all covenants. For further discussion regarding the Amended BofA Credit Facility, please refer to Note 7 Credit Facility to the Condensed Consolidated Financial Statements.

On July 14, 2009, we further amended and restated the Amended BofA Credit Facility, providing for an unsecured revolving credit facility (the Japanese BofA Credit Facility ) that enables VMS s Japanese subsidiary ( VMS KK ) to borrow up to 2.7 billion Japanese Yen. At any time amounts are outstanding under the Japanese BofA Credit Facility, 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 BofA Credit Facility. Borrowings under the Japanese BofA Credit Facility can be used by VMS KK for refinancing certain intercompany debts, working capital, capital expenditures and other lawful corporate purposes. Borrowings under the Japanese BofA Credit Facility accrue interest based on 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 Japanese BofA Credit Facility will expire on November 10, 2010. For further discussion regarding the Japanese BofA Credit Facility, please refer to Note 17 Subsequent Event to the Condensed Consolidated Financial Statements.

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 twelve 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 July 3, 2009 from 3.8% at September 26, 2008. The ratio of current assets to current liabilities increased to 1.97 to 1 at July 3, 2009 from 1.81 to 1 at September 26, 2008.

***Days Sales Outstanding***

Trade accounts receivable DSO, were 83 days at July 3, 2009 compared to 78 days at June 27, 2008. Our accounts receivable and DSO are primarily impacted by a number of factors: the timing of product shipments; collections performance; payment terms; and the mix of revenues from different regions. As of July 3, 2009, 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 July 24, 2007, our Board of Directors approved the repurchase of up to 12,000,000 shares of VMS common stock during the period beginning on July 30, 2007 through December 31, 2008. During the first nine months of fiscal year 2009, we paid $71.5 million to repurchase 1,548,000 shares of VMS common stock in accord with this authorization, all of which was repurchased during the first quarter of fiscal year 2009. All shares that have been repurchased have been retired. The authorization expired at the end of the first quarter, with 4,342,000 shares available for repurchase. On November 17, 2008, VMS s Board of Directors authorized the repurchase of an additional 8,000,000 shares of VMS common stock from January 1, 2009 through December 31, 2009. As of July 3, 2009, no repurchase had yet been made under the November 17, 2008 authorization.

***Contractual Obligations***

As a result of the adoption of FIN 48, we reclassified unrecognized tax benefits to long-term income taxes payable, which is included in Other long-term liabilities. 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 July 3, 2009, our liability for uncertain tax positions was $65.6 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.

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In October 2008, we consummated an agreement with Varian, Inc., or VI, under which VI will 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 our corporate headquarters in Palo Alto, California, will support the growth of our operations and our longer term objective of co-locating certain of our operations. Pursuant to this agreement, VI agreed to surrender the space in the building to us over the period which began in October 2008 and which ends in June 2010 and we 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 July 3, 2009, $5 million had been paid to VI pursuant to our agreement, and the remaining $16 million will be payable in June 2010.

In February 2009, we agreed to loan $14 million to dpiX in four separate installments over a period through October 2009. As of July 3, 2009, we had loaned $6.8 million to dpiX under this loan agreement and we expect to loan the remaining $7.2 million between July to October 2009. See detailed discussion in Note 5, Related Party Transactions to the Condensed 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 2008 Annual Report.

***Contingencies***

**Environmental Remediation Liabilities**

We are subject to a variety of environmental laws around the world regulating the handling, storage, transport and disposal of hazardous substances that do or may create increased costs for some of our operations. Although we follow procedures that we consider appropriate under existing regulations, these procedures can be costly and we cannot completely eliminate the risk of contamination or injury from these materials, and, in the event of such an incident, we could be held liable for any damages that result. In addition, we could be assessed fines or penalties for failure to comply with environmental laws and regulations. These costs and any future violations or liability under environmental laws or regulations could have a material adverse effect on our business.

In addition, we may be required to incur significant additional costs to comply with future changes in existing environmental laws and regulations or new laws and regulations. For example, several countries, including many in the European Union, or EU, are requiring medical equipment manufacturers to bear some or all of the cost of product disposal 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 require the adoption of restrictions on the use of some hazardous substances in certain of our products sold in the EU as well as providing material content information to customers and requested parties. This directive could increase costs for our operations.

From the time we began operating, we handled and disposed of hazardous materials and wastes following procedures that were considered appropriate under regulations, if any, existing at the time. We also hired companies to dispose of wastes generated by our operations. The U.S. Environmental Protection Agency, or EPA, or third parties have named us as a potentially responsible party, or PRP, under the Comprehensive Environmental Response Compensation and Liability Act of 1980, as amended, or CERCLA, at nine sites where we, as Varian Associates, Inc., are alleged to have shipped manufacturing waste for recycling or disposal. Therefore, as a PRP, we may have an obligation to reimburse the EPA or other third parties for cleanup costs at these sites. In addition, we are overseeing environmental cleanup projects and, as applicable, reimbursing third parties for cleanup activities under the direction of, or in consultation with, federal, state and/or local agencies at certain current VMS or former Varian Associates, Inc. facilities (including facilities disposed of in connection with our sale of our Electron Devices business during 1995 and the sale of our thin film systems business during 1997). Under the terms of the agreement governing the distribution of the shares, or the spin-offs, of VI and Varian Semiconductor Equipment Associates, Inc., or VSEA, by us in 1999, VI and VSEA are each obligated to indemnify us for one-third of these environmental cleanup costs (after adjusting for any insurance proceeds realized or tax benefits recognized by us).

As described below, we have accrued a total of $14.5 million at July 3, 2009 to cover our liabilities for these cleanup projects.

Various uncertainties make it difficult to estimate, or determine the likelihood within a range of estimates of, the project management costs, legal costs and costs of certain third-party claims at all of the sites and facilities. In addition, for the nine sites and one of the facilities, various uncertainties make it difficult to assess the likelihood and scope of further cleanup activities or to estimate the future cost of such activities. As of July 3, 2009, we nonetheless

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estimated that our future exposure (net of VI s and VSEA s indemnification obligations) for the cleanup costs for these ten locations, as well as project management costs, legal costs and the costs of certain third party-claims for all locations ranged in the aggregate from $3.1 million to $7.4 million. We believe that no amount in the range of estimated future costs is more probable of being incurred than any other amount in the range and therefore we have accrued $3.1 million for these cleanup projects as of July 3, 2009. The amount accrued has not been discounted to present value due to the uncertainties that make it difficult to develop a best estimate of future costs.

As to all other facilities, we have gained sufficient knowledge to better estimate the scope and costs of future cleanup activities based upon formal agreements with other parties defining our future liabilities or formal cleanup plans that have either been approved by or completed in accordance with the requirements of the state or federal environmental agency with jurisdiction over the facility. As of July 3, 2009, we estimated that our future exposure (net of VI s and VSEA s indemnification obligations) for the cleanup costs at these facilities, and reimbursements of third party s claims for these facilities, ranged in the aggregate from $7.5 million to $36.4 million. The time frames over which these cleanup project costs are estimated vary, ranging from 1 year to 30 years as of July 3, 2009. As to each of these facilities, management determined that a particular amount within the range of estimated costs was a better estimate of the future environmental liability than any other amount within the range, and that the amount and timing of these future costs were reliably determinable. The best estimate within the range was $15.9 million at July 3, 2009. We accordingly accrued $11.4 million, which represents our best estimate of the future costs of $15.9 million discounted at 4%, net of inflation. This accrual is in addition to the $3.1 million described in the preceding paragraph.

When we developed the estimates above, we considered the financial strength of other potentially responsible parties. These amounts are, however, only estimates and may be revised in the future as we get more information on these projects. We may also spend more or less than these estimates. Based on current information, we believe that our reserves are adequate, but as the scope of our obligations becomes more clearly defined, these reserves (and the associated indemnification obligations of VI and VSEA) may be modified and related charges/credits against earnings may be made.

We receive certain cash payments in the form of settlements and judgments from defendants, our insurers and other third parties from time to time. We have also reached an agreement with an insurance company under which the insurance company has agreed to pay a portion of our past and future environmental-related expenditures, and we, therefore, had included a $2.9 million receivable primarily in Other assets at July 3, 2009. We believe that this receivable is recoverable because it is based on a binding, written settlement agreement with a solvent and financially viable insurance company and the insurance company has paid the claims that we have made in the past.

Our present and past facilities have been in operation for many years, and over that time in the course of those operations, these facilities have used substances, that are or might be considered hazardous, and we have generated and disposed of wastes, that are or might be considered hazardous. Therefore, it is possible that additional environmental issues may arise in the future that we cannot now predict.

**Acquisition-Related Commitments/Obligations**

When we acquired ACCEL in January 2007, ACCEL was involved in a contract-related lawsuit. Subsequent to the acquisition, we settled this lawsuit and agreed to perform certain services under a new contract for a fixed price. From January to September 2007, we gathered information related to the expected cost of satisfying our contractual commitments and completed our assessment as of September 28, 2007. As a result, the final purchase price allocation of ACCEL included a loss accrual related to this contingency of 28.3 million. In the third quarter of fiscal year 2009, we increased the cost estimate to complete our contractual commitments by 4.9 million, which was recorded in the Condensed Consolidated Statement of Earnings. 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. As of July 3, 2009, the balance of the loss accrual related to this contingency was 9.0 million. We are currently engaged in arbitration to resolve a dispute under the new contract.

**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, 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

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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 July 3, 2009, we have not incurred any significant costs to defend lawsuits or settle claims related to these indemnification arrangements since we spun off VI and VSEA 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 April 2009, the Financial Accounting Standards Board, or FASB issued FASB Staff Position, or FSP No. FAS 107-1 and Accounting Principles Bulletin, or APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments,* or FSP 107-1. FSP 107-1 amends FASB No. 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. FSP 107-1 also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods. The adoption of FSP 107-1 in the third quarter of fiscal year 2009 did not have a material impact on our consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued Statement of Financial Accounting Standards, or SFAS No. 141 (revised 2007), *Business Combinations*, or SFAS 141(R). SFAS 141(R) 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. SFAS 141(R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. In April 2009, the FASB issued FSP No. FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*, or FSP 141(R)-1. FSP 141(R)-1 amends and clarifies SFAS 141(R) on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The provisions of SFAS 141(R) and FSP No. 141(R)-1 will be effective for us in the first quarter of fiscal year 2010. The impact of the adoption of SFAS 141(R) and FSP No. 141(R)-1 will depend on the nature and extent of business combinations occurring on or after the beginning of fiscal year 2010.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51*, or SFAS 160. SFAS 160 establishes accounting and reporting standards 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. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. The provisions of SFAS 160 will be effective for us in the first quarter of fiscal year 2010. We do not expect that the adoption of SFAS 160 will have a material impact on our consolidated financial position, results of operations and cash flows.

In November 2008, the FASB ratified EITF Issue No. 08-6, *Equity Method Investment Accounting Considerations*, or EITF 08-6. EITF 08-6 clarifies the accounting for certain transactions and impairment considerations involving equity method investments. The provisions of EITF 08-6 will be effective for us in the first quarter of fiscal year 2010, with early adoption prohibited. We are currently assessing the potential impact, if any, EITF 08-6 may have on our consolidated financial position, results of operations and cash flows.

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In December 2008, the FASB issued FSP No. FAS 132(R)-1, *Employers Disclosures about Postretirement Benefit Plan Assets*, or FSP 132(R)-1. FSP 132(R)-1, which amends SFAS 132(R), *Employers Disclosures about Pensions and Other Postretirement Benefits*, provides guidance on an employer s disclosure about plan assets of a defined benefit pension or other postretirement plan and requires employers to disclose information about fair value measurements of plan assets similar to the disclosure about fair value measurements requirement under SFAS No. 157, *Fair Value Measurements*, or SFAS 157. The provisions of FSP No. 132(R)-1 will be effective for us as of the end of fiscal year 2010.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events*, or SFAS 165, which establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. The adoption of SFAS 165 in the third quarter of fiscal year 2009 did not have a material impact on our consolidated financial position, results of operations or cash flows.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*, or SFAS 167. SFAS 167 amends the consolidation guidance for variable-interest entities under FASB Interpretations No. 46(R), *Consolidation of Variable Interest Entities: an interpretation of ARB No. 51*, 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. The provisions of SFAS 167 will be effective for us in the first quarter of fiscal year 2011. We are currently assessing the potential impact, if any, SFAS 167 may have on our consolidated financial position, results of operations and cash flows.

On July 1, 2009, the FASB released the authoritative version of its new *Accounting Standards Codification*, or the Codification, as the single authoritative source for GAAP. The Codification replaces all previous GAAP accounting standards as described in SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*, or SFAS 168. While not intended to change GAAP, the Codification significantly changes the way in which the accounting literature is organized. It is structured by accounting topic to help accountants and auditors more quickly identify the guidance that applies to a specific accounting issue. The provisions of SFAS 168 will be effective for us in the fourth quarter of fiscal year 2009. The adoption of the Codification will not have an effect on our consolidated financial position, results of operations and cash flows. However, because the Codification completely replaces existing standards, it will affect the way GAAP is referenced by us in our consolidated financial statements.

**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 since 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.

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We have many transactions denominated in foreign currencies and address certain of those financial exposures through a program of risk management that includes the use of derivative financial instruments. We sell products throughout the world, often in the currency of the customer s country, and typically hedge certain of these larger foreign currency transactions when they are not 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 forward exchange contracts outstanding as of July 3, 2009 were $216.0 million and $51.5 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 July 3, 2009. The principal amount of cash and cash equivalents at July 3, 2009 totaled $472 million with a weighted average interest rate of 0.35%.

The Amended BofA Credit Facility and the Japanese BofA Credit Facility allow us to borrow up to an aggregate maximum amount of approximately $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 accrue interest based on the LIBOR, the federal funds rate, or the BofA s prime rate plus a margin. Borrowings under the Japanese BofA Credit Facility accrue interest based on 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 and the Japanese BofA Credit Facility. As of July 3, 2009, there was no outstanding balance under these credit facilities. See a detailed discussion of our credit facilities 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 $32.5 million of long-term debt (including the current maturities of long term debt) outstanding as of July 3, 2009 that carried at a weighted average fixed interest rate of 6.9% with principal payments due in various installments over a five-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 (95% of which was held abroad at July 3, 2009 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

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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 third quarter of fiscal year 2009 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 and in Management s Discussion and Analysis of Financial Condition and Results of Operations under the caption Contingencies, and such discussions are 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 September 26, 2008 should be carefully considered. The risks and uncertainties described below are not the only ones we face. 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 materially 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***

The marketplace for our radiation therapy products, including our Oncology Systems products, is characterized by rapid change and technological innovation. Because our products often have long development and government approval cycles, we must anticipate changes in the marketplace and the direction of technological innovation and customer demands. For example, most of our recent product introductions in our Oncology Systems business segment have related to IMRT, IGRT, and VMAT, and enhancements of existing products through greater systems integration and simplification.

We believe that IMRT and IGRT have become accepted standards for treatment in the radiation oncology market. Demand for our products for IMRT has been a historical driver for our net orders and revenues in our Oncology Systems business segment and, now, demand for our products for IGRT has been one of the main contributors to more recent net orders and revenues. However, if future studies contradict current knowledge about IMRT or IGRT or otherwise 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 fail to increase or could decrease. Our success will also depend upon the continued acceptance and success of IMRT and IGRT in general and acceptance of our products utilizing this technology in particular. However, as more institutions purchase IMRT- or IGRT-equipped linear accelerators or upgrade their existing accelerators with IMRT or IGRT technology, 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 our future success in Oncology Systems is, in part, dependent upon the acceptance and success of VMAT in general and acceptance of our RapidArc products in particular. We believe that our new RapidArc products for VMAT are the next significant advance in IMRT cancer treatments and can help drive longer term demand for our linear accelerator products and our IMRT-related products. In fact, orders for our RapidArc have been a significant contributor to our recent net orders growth. However, 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 future studies contradict current knowledge about VMAT or our RapidArc products or otherwise call into 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, which would result in negative impact on our net orders and revenues. Furthermore, if third party, non-Company information systems do not support our VMAT technology, we may not be able gain sufficient adoption of our RapidArc products and VMAT technology among customers that have non-Company information systems, which would also inhibit our ability to gain wide-spread acceptance of our RapidArc products and, accordingly, could result in a negative impact to our net orders and revenues.

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As radiation oncology treatment becomes more complex, our customers are increasingly interested in the interconnectivity and simplicity of use of our various products for treating patients. For example, our linear accelerators, treatment simulators, treatment verification products and treatment planning and information management software products are highly sophisticated and require a high level of training and education in order to use them competently and safely. The complexity and training requirements are further increased by the products capability of operating together within integrated environments. We have directed substantial product development efforts into (i) tighter interconnectivity of our products for more seamless operation within a system, (ii) simplifying the usability of our software products and (iii) lowering setup and treatment times and increasing patient throughput, while maintaining an open systems approach that allows customers the flexibility 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 modalities of radiation therapy treatment methodologies. We anticipate that these efforts will increase the acceptance and adoption of IMRT, VMAT and IGRT and will foster greater demand for our products from new customers and upgrades from existing customers. However, we face competition from closed-ended dedicated-use systems that emphasize simplicity of use while sacrificing the ability for customers to customize the system to their individual needs, incorporate products from other manufacturers, share information with other systems or products, or use the equipment for differing modalities of radiation therapy treatment methodologies. If we have misjudged the importance to our customers of maintaining an open systems approach while enabling greater interconnectivity, simplicity-of-use and lowering setup and treatment times, or if we are unsuccessful in these efforts to enable greater interconnectivity, enhance simplicity-of-use efforts and setup and treatment times, our revenues could fail to increase or could decrease.

The acquisition of ACCEL (now Varian Medical Systems Particle Therapy GmbH) should enable us to develop and offer products for delivering image-guided, intensity-modulated proton therapy for the treatment of cancer. While we intend to continue to invest in product development relating to proton therapy treatment capabilities, acceptance of this technology may be slower than with our other cancer treatment technologies due to the relatively large scale, higher 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 of this business 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. If proton therapy fails to be effective as a treatment modality, or if proton therapy fail to become widely utilized, our orders and revenues may not materialize.

Our X-ray Products business segment sells products primarily to a limited number of large imaging system OEM customers who incorporate our products into their medical diagnostic imaging systems and industrial imaging systems. Some of these companies also manufacture x-ray tubes or flat panel detectors for their own systems. We, therefore, compete with these 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 our customer demands for lower cost, better product quality and/or 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 revenues could fail to increase or could decrease as our customers purchase from their internal manufacturing operations or from other independent x-ray tube or flat panel detector manufacturers.

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 GENERATIONS OF PRODUCTS AND ENHANCEMENTS TO EXISTING PRODUCTS, WE MAY BE UNABLE TO ATTRACT OR RETAIN CUSTOMERS OR GAIN ACCEPTANCE OF OUR PRODUCTS BY CUSTOMERS***

Our success depends upon 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, new product introductions of our competitors. Our X-ray Products business segment must also continually innovate to develop products with lower cost, better product quality and superior technology and performance. Accordingly, many of our products require significant planning, design, development and testing at the technological, product and manufacturing process levels. In addition, we are making significant investments in long-term growth initiatives, such as development of our SIP and Particle Therapy businesses, and

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expect that further efforts will be necessary to develop and commercialize some of the products and technology of these businesses. These activities require significant capital commitments, involvement of our 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 these products. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of new products or enhancements. In addition, a few of our research and development projects have been and in the future may be funded by government contracts. Changes in government priorities and our ability to attract similar funding may affect our overall research effort and ultimately, our ability to develop successful new products and product enhancements.

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;
- 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 efforts.

Additionally, our ability to gain healthcare market acceptance and demand for our new radiation therapy products and treatment procedures may be also affected by the budgeting cycles of hospitals and clinics for capital equipment purchases, which are frequently fixed one or more years in advance, and are experiencing increasing pressure in the current macroeconomic environment, 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 phase in new products, treatment systems or product enhancements. The roll-out of new products, systems and product enhancements involves compliance with complex quality assurance processes, including the Quality System Regulation, or QSR, of the U.S. Food and Drug Administration, or the FDA. Failure to complete these processes timely and efficiently could result in delayed introduction of new products, treatment systems and product enhancements. Without the successful introduction of new products, systems and product enhancements, we may be unable to attract and retain customers, causing our revenues and operating results to suffer. Additionally, if we fail to successfully manage the transition from old products to new products, systems and product enhancements, our customers may delay or cancel orders, which would adversely affect our revenues and operating results.

In addition, the installation times associated with new products generally are longer than with well-established products. Because recognition of a portion of the revenue associated with products 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 associated with new products, such as we have done with installation times for OBI, we cannot assure you that these plans will be successful or have a meaningful impact on reducing associated revenue recognition deferrals. Furthermore, even if our plans to decrease installation times 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 may be adversely impacted over a longer period of time, and our financial results could be adversely affected.

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***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 51% and 49% of revenues from continuing operations during the third quarter of fiscal years 2009 and 2008, respectively. As a result, we must provide significant service and support on a worldwide basis, and we have sales and service offices located in Europe, Asia, South America and Australia. In addition, we have manufacturing and research operations in England, Germany, Switzerland, France, Finland and China. We also invested in the expansion of our China x-ray business through our acquisition of Pan-Pacific Enterprises, Inc. We have invested and will continue to invest substantial financial and management resources to develop an international infrastructure 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 longer period from shipment to revenue recognition resulting in greater revenue recognition deferrals, higher backlog and a lower gross margin on our products;
- our ability to obtain export licenses and other required export or import licenses or approvals;
- 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 comply with local laws and requirements regarding conducting business 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 the geographic distribution of our orders and sales may fluctuate from period to period, it has been generally trending increasingly towards our international regions. 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 July 3, 2009, 95% 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 such repatriation. Additionally, this could cause our overall tax rate to increase. This could cause our business and results of operations to suffer.

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, which could adversely affect our results of operations. 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.

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***OUR RESULTS OF OPERATIONS MAY BE ADVERSELY IMPACTED BY THE WORLDWIDE MACROECONOMIC DOWNTURN***

Since 2008, general worldwide economic conditions have experienced a severe downturn due to the sequential effects of the subprime lending crisis, general 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 macroeconomic conditions have deteriorated further in 2009. These conditions have shrunk capital equipment budgets, slowed decision-making, made financing for big ticket 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 cause our customers to freeze or dramatically reduce purchases and capital project expenditures, and may result in consolidation of our customers and disruption of supply as vendors consolidate or go out of business. A reduction in net orders or disruption in supply as affected and may in the future affect our operating results, financial condition and the price of VMS common stock. Furthermore, these conditions and their effects on our customers and vendors also make it difficult for us to accurately forecast and plan our future business activities. We cannot predict the timing or duration of the economic downturn or the timing or strength of a subsequent economic recovery, in general or specifically in the healthcare industry. If the healthcare market significantly deteriorates due to these macroeconomic effects, our business, financial conditions and results of operations will likely be materially and adversely affected.

***OUR RESULTS MAY BE ADVERSELY AFFECTED BY CHANGES IN FOREIGN CURRENCY EXCHANGE RATES***

Because we sell our products internationally and have international operations, we are also subject to market risk due to fluctuations in foreign currency exchange rates, which may affect product demand, our expenses and/or the profitability in U.S. dollars of products and services provided by us in foreign markets where payment for our products and services or of our expenses is made in the local currency. 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 to mitigate the effects of operational (sales transactions) and balance sheet exposures to fluctuations in foreign currency exchange rates. Our forward exchange contracts generally range from one to twelve months in maturity.

Although we engage in hedging strategies that may 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 of movement of foreign currency exchange rates. In particular, foreign currency exchange rates in worldwide currencies have been extremely volatile over short periods of time since the beginning of 2008. If our hedging strategies are not effective in offsetting the effect of fluctuations in foreign currency exchange rates, our revenues and other operating results may be harmed. In addition, because currencies fluctuate and we engage in hedging strategies over time, movement in foreign currency exchange rates could impact our financial results positively or negatively in one period and not another, and therefore make comparing our financial results from period to period more difficult.

In addition, long-term movements in foreign currency exchange rates could affect the competitiveness of our products. Even though sales of our products internationally occur predominantly 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, so our overall margins and pricing competitiveness may be adversely affected. The weakening U.S. dollar that we have experienced over the last several years has made our pricing more competitive with our foreign competitors, which has been a contributor to our international order and revenue growth. The strengthening of the U.S. dollar against other countries currencies that we have experienced more recently has made and may continue to make our pricing less competitive and result in slower growth or declines in our international orders and revenues, which then could negatively affect 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.

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***WE FACE SIGNIFICANT COSTS IN ORDER TO COMPLY WITH LAWS AND REGULATIONS APPLICABLE TO THE MANUFACTURE AND DISTRIBUTION OF OUR PRODUCTS, AND IF WE FAIL OR ARE DELAYED IN OBTAINING REGULATORY CLEARANCES OR APPROVALS OR FAIL TO COMPLY WITH APPLICABLE LAWS AND REGULATIONS, WE MAY BE UNABLE TO DISTRIBUTE OUR PRODUCTS OR MAY BE SUBJECT TO SIGNIFICANT PENALTIES***

Our products and the products 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 Commission, or 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. We are also subject to similar international regulations depending on the countries in which we sell our devices. 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 before we, as a manufacturer of medical devices, can take orders for or market or sell those products in the United States. In addition, 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 require a new 510(k) clearance. Obtaining clearances or approvals is time-consuming, expensive and uncertain. We may fail to obtain the necessary clearances or approvals or may be unduly delayed in doing so. 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 either 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 pre-market approval, or PMA, process. There have been recent discussions in medical and regulatory publications advocating for increased FDA review of certain medical devices by disallowing such devices from 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, and could cause substantial harm to our business.

*Marketing a medical device internationally.* In order for us to market our products internationally, we are required to obtain market clearances or approvals for future products or product modification. These clearance or approval processes could be lengthy, resulting in a significant delay to our ability to market product in those countries, specifically in the European Economic Area, or EEA, China, Japan and Canada. Obtaining market clearance or product approvals can be time consuming, expensive, and uncertain, and we may fail to obtain the clearance or approvals on one or more of our products, or may be unduly delayed in doing so. 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.

Specifically, within the EEA, we must meet the CE marking requirements. A CE mark is a European marking of conformity that indicates that a product complies with the essential requirements of the applicable European laws or directives by meeting 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 affixed. After the CE mark is affixed to the device, which we would do once conformity is verified, the Notified Body would regularly audit us to ensure that we remain in compliance with the applicable European laws or directives. CE marking is required on products in the countries of the EEA and provides a means for us to demonstrate 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 are unable to support our performance claims and demonstrate compliance with the applicable European laws and directives to our Notified Body and/or competent authorities, we may risk losing our CE mark, which would prevent us from selling our products within the EEA.

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We may also face regulatory requirements in other countries aside from those identified, and those requirements may be more or less restrictive, and which we may not be able to meet. This may limit or prevent our ability to market our products in one or more other countries or regions.

*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, or MDR regulations, and similar international adverse event reporting regulations, which 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. There can be no assurance disposal sites for the lawful disposal of materials generated by the manufacture, use or decommissioning of our products will continue to accept such materials in the future, or under terms which are favorable.

The FDA and the Federal Trade Commission, or FTC, also regulate advertising and promotion of our products to ensure that the claims we make are consistent with our regulatory clearances, that there is 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.

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 1996, or HIPAA, and similar data privacy laws and regulations in foreign countries, fraud and abuse laws and regulations, including, physician self-referral prohibitions, anti-kickback laws and false claims laws. 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.

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If we or any of our suppliers or distributors 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, or the refusal of future requests for clearance or approval;
- 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.

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. In addition, new laws and regulations may be adopted, which adversely affect 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.

***WE FACE SIGNIFICANT COSTS IN ORDER TO COMPLY WITH FOREIGN LAWS AND REGULATIONS APPLICABLE TO THE MANUFACTURE AND DISTRIBUTION OF OUR PRODUCTS.***

Our operations and sales of our products outside the United States are subject to regulatory requirements that vary from country to country, and may differ significantly from those in the United States. In general, our products are regulated outside the United States as medical devices by foreign governmental agencies similar to the FDA. We are also subject to laws and regulations outside the United States applicable to

manufacturers of radiation-producing devices and products utilizing radioactive materials, and laws and regulations of general applicability relating to matters such as environmental protection, safe working conditions, manufacturing practices and other matters, in each case that are often comparable, if not more stringent, than regulation in the United States. In addition, our sales of products in foreign countries are subject to regulation of matters such as product standards, packaging requirements, labeling requirements, environmental and product recycling requirements, import and export restrictions, tariff regulations, duties and tax requirements. In some countries, we rely on our foreign distributors to assist us in complying with foreign regulatory requirements. 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 the applicable country or subject us to a variety of enforcement actions, which would adversely affect our business.

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***WE ARE SUBJECT TO FEDERAL, STATE AND FOREIGN LAWS GOVERNING OUR BUSINESS PRACTICES WHICH, IF VIOLATED, COULD SUBJECT US TO SUBSTANTIAL PENALTIES. ADDITIONALLY, ANY CHALLENGES TO OR INVESTIGATION INTO OUR PRACTICES UNDER THESE LAWS 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, including sales programs, we may have with hospitals, physicians or other potential purchasers of our products. In particular, these laws influence, among other things, 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 individuals or entities from 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. Anti-kickback and false claims laws prescribe civil and criminal penalties, which can be substantial, and potential exclusion from healthcare programs for noncompliance. Moreover, even an unsuccessful challenge or investigation into our practices could cause adverse publicity, and be costly to respond to, 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 such proposals or bills were to become law, the implementation of the necessary infrastructure to comply with such laws could be quite costly.

In addition, we are subject to similar laws in foreign countries where we conduct business. As an example, within the 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. Moreover, industry associations closely monitor the activities of member companies. If these organizations or national authorities were to 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.

***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,

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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 are used as part of an overall process that takes place within our customers facilities and network systems, and under quality assurance, or QA, procedures established by the facility that ultimately result in the delivery of radiation to patients. Additionally, 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 or others for damages resulting from the faulty or allegedly faulty design, manufacture, installation, servicing, support, testing, interoperability or the misuse of our products. 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 the installation, servicing and support of our products. With any accident, we could be subject to legal costs, adverse publicity and damage to our reputation, whether or not our products or services were a factor. Furthermore, adverse publicity regarding accidents or mistreatments involving radiation therapy 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 modalities of treatment.

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 cause customers to review and potentially terminate their relationships with us. These recalls, especially if accompanied by unfavorable publicity or cancellation of customer orders and service contracts, could result in our incurring substantial costs and management time, losing revenues and damaging our reputation, each of which would harm our business. Further, product recalls may also result in unexpected 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. In the future, these policies may not be available on acceptable terms or in sufficient amounts, if at all. In addition, the insurance coverage we have obtained may not be adequate. 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.

***THE MARKETS IN WHICH WE COMPETE ARE HIGHLY COMPETITIVE, 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***

The markets for radiation therapy equipment and software are characterized by rapidly evolving technology, intense competition and pricing pressure. Some of our competitors have greater financial, marketing and other resources than we have. Also, we believe that the rapid technological changes occurring in our markets will lead to the entry of new competitors into our markets, as well as our encountering new competitors as we apply our technologies in new market segments such as stereotactic radiosurgery, VMAT and proton therapy. Our ability to compete successfully depends, in part, on our ability to provide technologically 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. Our ability to compete in the radiation therapy market may be adversely affected when purchase decisions are based solely upon price, since our products are generally sold on a total value to the customer basis. This may occur if hospitals and clinics give purchasing decision authority to group purchasing organizations that focus solely on pricing as the primary determinant in making purchase decisions. In addition, the presence of additional competitors may delay customer purchasing decisions as customers evaluate the products of these competitors along with ours. These delays can extend our sales cycle and therefore adversely affect our net orders and operating results. In radiotherapy and radiosurgery markets, we compete primarily with Siemens Medical Solutions, Elekta AB (which recently acquired Computerized Medical Systems, Inc.), 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 AB, Philips Medical Systems, Best Theratronics, Ltd., Nucletron B.V. and Siemens Medical Solutions. We also have begun to encounter some competition from providers of hospital information systems. With respect to 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.

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The market for x-ray imaging components and subsystems is extremely competitive, with our competitors frequently having 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 tubes, also manufacture x-ray tubes 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 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. There is no single major competitor in this nondestructive testing market.

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 technologically 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., Hitachi Medical Corporation, Siemens Medical Solutions and Still River Systems, Inc. The presence of competitors may delay customer purchasing decisions as customers evaluate the products of these competitors along with ours.

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 are 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 or operate under the same standards, regulatory and/or other legal requirements that we do, 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.

***INTEROPERABILITY OF OUR PRODUCTS WITH ONE ANOTHER AND THEIR COMPATIBILITY WITH THIRD-PARTY PRODUCTS IS BECOMING INCREASINGLY IMPORTANT, AND IF WE ARE UNABLE TO MAKE OUR PRODUCTS INTEROPERATE WITH ONE ANOTHER OR COMPATIBLE WITH WIDELY USED THIRD-PARTY PRODUCTS, SALES OF OUR PRODUCTS COULD DECREASE***

As radiation therapy becomes more and more complex, our customers are increasingly concerned about the interoperability and compatibility of the various products they use in providing treatment to patients. For example, our linear accelerators, treatment simulators, treatment verification products, treatment planning and information management software products are designed to interoperate with one another, and to be compatible with other widely used third-party radiation oncology products. Obtaining and maintaining this interoperability and compatibility is costly and time-consuming. When third parties modify the design or functionality of their products, it can require us to modify our products to ensure compatibility. Conversely, when we implement design improvements to our products, customers may be reluctant to adopt our new technology due to interoperability issues; for example, a clinic may be unwilling to implement one of our new technologies because its third-party software network provider does not yet have a proper software interface available. In addition, our ability to obtain compatibility with third-party products can depend on the third parties providing us with adequate information regarding their products. In many cases, these third parties are our competitors and may time their product

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changes, and their sharing of relevant information with us, to place us at a competitive disadvantage. Further, we could be required to obtain additional regulatory clearances for any modification of our products due to interoperability issues with the products of third parties. It is also possible that, despite our best efforts, we may be unable 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.

***WE MAY INCUR SUBSTANTIAL COSTS IN PROTECTING OUR INTELLECTUAL PROPERTY, AND IF WE ARE NOT ABLE TO DO SO, OUR COMPETITIVE POSITION WOULD BE HARMED***

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. We could incur substantial costs and diversion of management resources if we have to assert our patent rights against others in litigation or other legal proceedings. 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. We cannot assure you that these protections will prove adequate, that agreements will not be breached, that we will have adequate remedies for any breach, or that our trade secrets will not 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. We cannot assure you that unauthorized third parties will not use our trademarks. 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. We cannot assure you that we would prevail in any such dispute. We also do not maintain insurance for such intellectual property infringement. Therefore, if we are unsuccessful in defending any such 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. We cannot assure you that any licenses required would be made available to us on acceptable terms or at all.

***SINCE WE DEPEND UPON A LIMITED GROUP OF SUPPLIERS, AND IN SOME CASES SOLE SOURCE SUPPLIERS, FOR SOME PRODUCT COMPONENTS, THE LOSS OF A SUPPLIER OR ANY INABILITY TO OBTAIN SUPPLIES OF THESE COMPONENTS COULD REDUCE OUR ABILITY TO MANUFACTURE PRODUCTS, CAUSE MATERIAL DELAYS IN OUR ABILITY TO DELIVER PRODUCTS, OR SIGNIFICANTLY INCREASE OUR COSTS; SHORTAGES OF KEY RAW MATERIALS COULD HAVE A SIMILAR EFFECT***

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, sesium 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. Although we have obtained limited insurance to protect against business interruption loss, we cannot assure you that this insurance coverage will be adequate or that it will 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. In addition, 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 dramatically over the last few years, resulting in limited supplies and significantly higher prices. Worldwide demand, availability and pricing of these raw materials have been volatile, and we expect that they 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 AND THEREFORE OUR FINANCIAL RESULTS***

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 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 WHOM ARE ALSO OUR COMPETITORS, AND THE LOSS OR REDUCTION IN PURCHASING VOLUME BY ONE OR MORE OF THESE CUSTOMERS OR CONSOLIDATION AMONG OEMS IN THE X-RAY TUBE PRODUCTS MARKET COULD REDUCE OUR SALES OF X-RAY TUBE PRODUCTS***

We sell our x-ray tube products to a limited number of OEM customers, many of which are also our competitors, for incorporation into diagnostic imaging systems. The loss of, or reduction in purchasing volume by, one or more of these customers would have a material adverse effect on our X-ray Products business. There has been a consolidation of diagnostic imaging systems manufacturers over the past few years. Any ongoing consolidation of customers who purchase our x-ray tube products, including the consolidation of these customers into companies that already manufacture x-ray tubes, could result in less predictable and reduced sales of our x-ray tube products. In addition, our OEM customers products, which also use our x-ray tubes, could lose market share to competitive products or technologies and, thereby, result in a reduction in our orders and revenues.

***WE SELL OUR LINATRON® X-RAY ACCELERATORS TO OEM CUSTOMERS WHO DEPEND ON CUSTOMER DELIVERY AND ACCEPTANCE SCHEDULES, WHICH MAY CAUSE ORDERS FOR OUR SECURITY AND INSPECTION PRODUCTS TO 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 private parties 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

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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 and the actual timing of sales and revenue recognition will vary significantly, as it is difficult to predict our OEM customer delivery and acceptance schedules.

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, all of which depend upon government budgets and appropriations that are subject to political changes, which may cause uncertainty and variability in the timing of orders. We have begun to see customers freeze or dramatically reduce purchases and capital project expenditures, or act cautiously as governments around the world wrestle with spending priorities. Thus, orders in any quarter or period are not necessarily directly correlated to the level of sales or revenues in any particular future quarter or period. This unpredictability in orders, sales and revenue timing 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 are often required 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 acceptance and adoption of our products for IMRT, IGRT, VMAT, stereotactic radiosurgery and proton therapy. The timing of our competitors introduction of products and the market acceptance of their products may also make this educational process more difficult. We cannot be sure that any products we develop will gain any significant market acceptance and market share among physicians, patients and healthcare payors, even if the required regulatory approvals are obtained.

***WE MAY NOT BE ABLE TO MAINTAIN OR EXPAND OUR BUSINESS IF WE ARE NOT ABLE TO RETAIN, HIRE AND INTEGRATE SUFFICIENTLY 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. The loss of services of key employees could adversely affect our business. Competition for key personnel can be intense. We compete for key personnel with other medical equipment and software manufacturers and technology companies, as well as universities and research institutions. Because the competition for qualified personnel 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.

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

As a manufacturer of products with a long production cycle, we need to anticipate demand for our products in order to ensure adequate manufacturing or testing capacity. We cannot assure you that we will be able to anticipate demand adequately or to adjust our resources appropriately. If our manufacturing or testing capacity does not keep pace with product demand, we will not be able to fulfill orders in a timely manner, which in turn may have a negative effect on our financial results and overall business. Conversely, if demand for our products decreases, the fixed costs associated with excess manufacturing capacity may adversely affect our financial results.

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***WE MAY ATTEMPT TO ACQUIRE NEW BUSINESSES, PRODUCTS OR TECHNOLOGIES, AND IF WE ARE UNABLE TO SUCCESSFULLY COMPLETE THESE ACQUISITIONS OR TO INTEGRATE ACQUIRED BUSINESSES, PRODUCTS, TECHNOLOGY OR EMPLOYEES, WE MAY FAIL TO REALIZE EXPECTED BENEFITS OR HARM OUR EXISTING BUSINESS***

Our success will depend, in part, on our ability to expand our product offerings and grow our businesses in response to changing technologies, customer demands and competitive pressures. In some circumstances, as a strategy to achieve quicker time to market for new products or technology, or to enter new markets, we may determine to grow our business through the acquisition of complementary businesses, products or technologies rather than through internal development. For example, in fiscal year 2008 we acquired Pan-Pacific, an independent distributor of medical x-ray tubes and other imaging components in China, and in fiscal year 2009 acquired certain assets of IKOE, a supplier of software used in the planning of radiotherapy and radiosurgery treatments. The identification of 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, the completion of an acquisition could divert our management and key personnel from our business operations, which could harm our business and affect our financial results. Furthermore, even if we complete an acquisition, we may not be able to successfully integrate newly acquired organizations, products or technologies or employees into our operations, or may not be able to realize some of the synergies expected from an acquisition. The process of integration could be expensive, time-consuming and may strain our resources. For example, we may encounter challenges in the commercialization of new products and may have to invest more than originally anticipated in order to do so, as we are experiencing with the 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 have recently done with respect to Research Instruments, we may encounter difficulty in finding 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. 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 could result in potentially dilutive issuances of equity securities or the incurrence of debt, contingent liabilities or expenses, or other charges such as in-process research and development, any of which could harm our business and affect our financial results.

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 allocate to goodwill a large portion of the purchase price of an acquired business, our operating results could suffer if we fail to achieve the anticipated growth from that acquisition.

***THE ACQUISITION OR DEVELOPMENT OF NEW LINES OF BUSINESS MAY SUBJECT US TO ADDITIONAL RISKS***

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 these efforts, particularly in instances where the markets are not fully developed. Risks include developing knowledge of and experience in the new business, recruiting professionals to manage the new business lines, increasing research and development expenditures, and developing and capitalizing on new marketing relationships with experienced market participants. Each new business may require the investment of additional capital and the significant involvement of our senior management to acquire or develop, then integrate, the new line of business into our operations. Initial timetables for the introduction and development of new lines of business 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 line of business will be successful. Failure to successfully manage these risks in the development and implementation of new lines of business could materially and adversely affect our business, results of operations and financial condition.

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***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 ACCEL Research Instruments business but retained responsibility for certain contracts. We may face difficulties and incur additional costs beyond our expected costs associated with these remaining obligations 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 UTILIZE DISTRIBUTORS FOR A PORTION OF OUR SALES, THE LOSS OF WHICH COULD HARM OUR REVENUES IN THE TERRITORY SERVICED BY THESE DISTRIBUTORS***

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

***HEALTHCARE REFORMS, CHANGES IN HEALTHCARE POLICIES AND CHANGES TO THIRD-PARTY REIMBURSEMENTS FOR RADIATION ONCOLOGY SERVICES MAY AFFECT DEMAND FOR OUR PRODUCTS***

The U. S. government has in the past considered, is currently considering and may in the future consider healthcare policies and proposals intended to curb rising healthcare costs, including those that could significantly affect both private and public reimbursement for healthcare services. State and local governments, as well as a number of foreign governments, are also considering or have adopted these types of policies. These policies have included, and may in the future include: basing reimbursement policies and rates on clinical outcomes, the comparative effectiveness and costs of different treatment technologies and modalities; imposing price controls on medical products and services providers; and other measures. Future significant changes in the healthcare systems in the United States or elsewhere could also have a negative impact on the demand for our products and services and our business. These include changes that may reduce reimbursement rates for procedures using our products and changes that may be proposed or implemented by the current U.S. Presidential administration or Congress. We believe that the current uncertainty created by the prospects of healthcare reform in the United States has impacted our Oncology Systems business, and we expect that this uncertainty will persist until there is greater clarity on healthcare reform. It is unclear which, if any, of the various U.S. healthcare reform policies currently being discussed and/or proposed might be enacted by the U.S. Congress and signed into law by the President. 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 legislation or regulation would have on our business; or the effect ongoing uncertainty about these matters will have on the purchasing decisions of our customers.

In addition, sales of our healthcare products indirectly depend on whether adequate reimbursement is available to our customers for the treatment provided by those products from third-party healthcare payors, 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 Centers for Medicare and Medicaid Services 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. Significant changes in the availability and amount of reimbursement for treatments using our products could influence our customers decisions. We have seen our customers decision-making process complicated by the currently proposed reduction in Medicare reimbursement rates for radiotherapy and radiosurgery at freestanding clinics in the United States, which we believe represents approximately 10% of Oncology Systems business. Additionally, proposed cuts to physician reimbursements for radiation oncology could negatively impact our business. Any significant cuts in these reimbursement rates, or other rates for radiotherapy, radiosurgery, proton therapy or brachytherapy, could further increase uncertainty, reduce demand for our products and have a material adverse effect on our revenues and stock price. We expect that uncertainty in North American radiation therapy capital spending will persist until there is greater clarity on reimbursement rates.

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As a general matter, third-party payors are increasingly challenging the pricing of medical procedures or limiting or prohibiting reimbursement for specific services or devices, 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. 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.

***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, the purchasing cycle 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;
- 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;

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;

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fluctuation in our effective tax rates 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;

the possibility that unexpected levels of cancellations of orders may affect certain assumptions upon which we base our forecasts and predictions of future performance;

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 adjustments, 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 particle 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 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. 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

may vary significantly from period to period, and our operating results and the trading price of VMS common stock may be adversely affected.

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In addition, many of the components used in proton therapy equipment require a long lead time, which may translate into 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. This could have an adverse effect on the trading price of VMS common stock.

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. These indemnification provisions could be limited to a percentage of the value of the project; however, due to the high dollar value of proton therapy projects, the liability that we would assume may nevertheless be substantial. Additionally, while the proton therapy market is still developing and proton therapy as a treatment modality is not yet widely utilized, 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 maintain compliance with specified financial ratios. We may have to curtail some of our operations to maintain compliance 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 have difficulty securing additional financing in the form of additional indebtedness. Furthermore, if we fail to comply with these covenants, requirements or any other provision of the credit facility, we may be in default under the credit facility, and we cannot assure you that we will be able to obtain the necessary amendments or waivers of a default. Upon an event of default under our credit facility not otherwise amended or waived, the lender could elect to declare all amounts outstanding under our revolving credit facility, together with accrued interest, to be immediately due and payable. If the payment of our indebtedness is accelerated, we cannot assure you that we will 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 Financial Accounting Standards Board, 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. For example, as a result of our adoption of FIN 48, our effective tax rate and other related financial metrics have fluctuated and may in the future fluctuate more than they have in prior periods.

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As our operations evolve over time, we may introduce new products or new technologies that require us to apply different accounting principles, including those regarding revenue recognition, than we have applied in past periods. For example, if we develop products that contain more software components, we may be required to recognize revenue for the software components together with the hardware components in accordance with software revenue recognition rules, which could delay recognition of some revenue. Additionally, while we recognize revenue for many of our Oncology Systems products in accordance with the provisions under Staff Accounting Bulletin No. 104 Revenue Recognition and SOP No. 97-2, *Software Revenue Recognition*, as amended by SOP No. 98-9, *Software Revenue Recognition with Respect to Certain Agreements*, we recognize revenues for a proton therapy commissioning service contract and for certain highly customized image detection systems in the SIP business, under the percentage-of-completion method or the completed-contract method in accordance with the provisions under SOP No. 81-1, *Accounting for Performance of Construction-Type and Certain Product Type Contracts*, or SOP 81-1, which affects the timing of revenue recognition. We could be required to apply these methods to other businesses in the future. 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 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 would be required to adjust revenues or even record a contract loss in later periods, and our financial results could suffer. Also, revenues related our proton therapy commissioning service contract is recognized under the completed contract method. 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 adjustments 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.

***THE NATURE OF OUR BUSINESS EXPOSES US TO ENVIRONMENTAL CLAIMS, CLEANUP COSTS, OR EXPENSES, WHICH COULD CAUSE US TO PAY SIGNIFICANT AMOUNTS***

We are subject to a variety of environmental laws around the world regulating the handling, storage, transport and disposal of hazardous materials and which impose liability for the cleanup of any contamination from these materials; these laws may create increased costs for some of our operations. Although we follow procedures that we consider appropriate under existing regulations, these procedures can be costly and we cannot completely eliminate the risk of contamination or injury from these hazardous materials; in the event of such an incident, we could be held liable for any damages that result. We do not maintain insurance for cleanup costs or third-party claims resulting from environmental contamination which could occur in the future. We do, however, maintain insurance policies that may provide coverage for cleanup costs or third-party claims resulting from some historical occurrences of environmental contamination although this insurance coverage may be inadequate to cover these costs or claims. We could also be assessed fines or penalties for failure to comply with environmental laws and regulations.

In addition, we may be required to incur significant additional costs to comply with future changes in existing environmental laws and regulations or new laws and regulations. For example, several countries, including many in the EU, are requiring medical equipment manufacturers to bear some or all of the cost of product disposal at the end of the product s useful life, thus creating increased costs for our operations. The EU has also adopted a directive that may require the adoption of restrictions on the use of certain hazardous substances in certain of our products sold in the EU. This directive 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. During the third quarter of fiscal year 2009, revenues recognized with longer or extended payment terms amounted to approximately 5% of total Oncology Systems revenues. While we qualify customers to whom we offer longer or extended payment terms, we cannot assure you that the financial positions of these customers will not change adversely over the longer time period given for payment. In such an event, we may experience an increase in payment defaults, which will 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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***WE RELY UPON CERTAIN CRITICAL INFORMATION SYSTEMS FOR OUR DAILY BUSINESS OPERATION, AND DISRUPTION OF THESE SYSTEMS COULD NEGATIVELY IMPACT OUR BUSINESS AND FINANCIAL CONDITION.***

We depend on our information technology to enable us to 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, WHICH WOULD ADVERSELY AFFECT OUR BUSINESS***

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. This coverage 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 manufacturing facilities; these delays could be lengthy and result in large expenses. If any of our customers facilities are adversely affected by a disaster, shipments of our products could be delayed even further. 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.

***SINCE OUR STOCKHOLDER RIGHTS PLAN EXPIRED, WE COULD FACE A HIGHER RISK OF A TAKEOVER***

Our stockholder rights plan expired in December 2008. We may not be able to implement a similar stockholder rights plan, which could put us at risk for a take-over, distract our management and adversely affect our business.

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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 third quarter of fiscal year 2009.

| 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) |
|---|---|---|---|---|
| April 4, 2009 - May 1, 2009 | | | | 8,000,000 |
| May 2, 2009 - May 29, 2009 | 629(2) | $ 35.33 | | 8,000,000 |
| May 30, 2009 - July 3, 2009 | | | | 8,000,000 |
| Total | 629 | $ | | |

(1) On July 24, 2007, VMS s Board of Directors approved the repurchase up to 12,000,000 shares of VMS common stock during the period beginning on July 30, 2007 through December 31, 2008. During the first quarter of fiscal year 2009, the July 24, 2007 authorization expired with 4,342,000 shares unpurchased. On November 17, 2008, VMS s Board of Directors approved the repurchase of 8,000,000 shares of VMS common stock over a period beginning on January 1, 2009 through December 31, 2009.

(2) Consisted of 629 shares of VMS common stock that were tendered to VMS in satisfaction of tax withholding requirements for vested 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.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 July 3, 2009 and June 27, 2008; (ii) Condensed Consolidated Statements of Earnings for the nine months ended July 3, 2009 and June 27, 2008; (iii) Condensed Consolidated Balance Sheets at July 3, 2009 and September 26, 2008; (iv) Condensed Consolidated Statements of Cash Flows for the nine months ended July 3, 2009 and June 27, 2008; and (v) Notes to Condensed Consolidated Financial Statements for the nine months ended July 3, 2009.

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, Varian Medical Systems, Inc. has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**VARIAN MEDICAL SYSTEMS, INC.**

*(Registrant)*

Dated: August 11, 2009

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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