

ACCURAY INC  
Form 10-Q  
November 08, 2012  
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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 September 30, 2012**

**or**

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

**For the transition period from                      to**

**Commission File Number: 001-33301**

**ACCURAY INCORPORATED**

(Exact Name of Registrant as Specified in Its Charter)

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**Delaware**

(State or Other Jurisdiction of Incorporation or Organization)

**20-8370041**

(IRS Employer Identification Number)

**1310 Chesapeake Terrace**

**Sunnyvale, California 94089**

(Address of Principal Executive Offices Including Zip Code)

**(408) 716-4600**

(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 reports), and (2) has been subject to such filing requirements for the past 90 days. ☒ Yes ☐ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer ☐

Accelerated filer ☒

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

Smaller reporting company ☐

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

As of October 26, 2012, there were 72,273,072 shares of the Registrant's Common Stock, par value \$0.001 per share, outstanding.

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**Accuray Incorporated**

**Form 10-Q for the Quarter Ended September 30, 2012**

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements****Accuray Incorporated****Condensed Consolidated Balance Sheets**

(in thousands, except share and per share amounts)

(Unaudited)

|  | September 30,<br>2012 | June 30,<br>2012 (1) |
|--|-----------------------|----------------------|
| <b>Assets</b>  |                       |                      |
| Current assets:  |                       |                      |
| Cash and cash equivalents  | \$ 121,861            | \$ 143,504           |
| Restricted cash  | 2,611                 | 1,560                |
| Accounts receivable, net of allowance for doubtful accounts of \$1,773 and \$1,700, respectively   | 57,620                | 67,890               |
| Inventories  | 81,739                | 81,693               |
| Prepaid expenses and other current assets  | 17,619                | 16,715               |
| Deferred cost of revenue - current   | 4,078                 | 4,896                |
| Total current assets   | 285,528               | 316,258              |
| Property and equipment, net  | 39,536                | 37,458               |
| Goodwill   | 59,344                | 59,215               |
| Intangible assets, net   | 39,122                | 49,819               |
| Deferred cost of revenue - noncurrent  | 3,575                 | 2,433                |
| Other assets   | 10,912                | 7,987                |
| Total assets   | \$ 438,017            | \$ 473,170           |
| <b>Liabilities and equity</b>  |                       |                      |
| Current liabilities:   |                       |                      |
| Accounts payable   | \$ 28,025             | \$ 18,209            |
| Accrued compensation   | 16,226                | 23,071               |
| Other accrued liabilities  | 27,025                | 31,646               |
| Customer advances - current  | 21,173                | 18,177               |
| Deferred revenue - current   | 77,797                | 83,071               |
| Total current liabilities  | 170,246               | 174,174              |
| Long-term liabilities:   |                       |                      |
| Long-term other liabilities  | 5,592                 | 5,988                |
| Deferred revenue - noncurrent  | 12,582                | 9,675                |
| Long-term debt   | 80,507                | 79,466               |
| Total liabilities  | 268,927               | 269,303              |
| Commitment and contingencies (Note 5)  |                       |                      |
| Equity:  |                       |                      |
| Preferred stock, \$0.001 par value; authorized: 5,000,000 shares; no shares issued and outstanding |                       |                      |
| Common stock, \$0.001 par value; authorized: 100,000,000 shares; issued and outstanding:           |                       |                      |
| 72,143,926 and 71,864,268 shares at September 30 and June 30, 2012, respectively                   | 72                    | 72                   |
| Additional paid-in capital   | 411,136               | 409,143              |

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|  |            |            |
|--|------------|------------|
| Accumulated other comprehensive income | 2,302      | 2,837      |
| Accumulated deficit                    | (240,557)  | (216,427)  |
| Total stockholders' equity             | 172,953    | 195,625    |
| Non-controlling interest               | (3,863)    | 8,242      |
| Total equity                           | 169,090    | 203,867    |
| Total liabilities and equity           | \$ 438,017 | \$ 473,170 |

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(1) The condensed consolidated balance sheet at June 30, 2012 has been derived from audited consolidated financial statements.

*The accompanying notes are an integral part of these condensed consolidated financial statements.*

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**Accuray Incorporated**
**Condensed Consolidated Statements of Operations and Comprehensive Loss**

(in thousands, except per share amounts)

(Unaudited)

|   | <b>Three Months Ended<br/>September 30,</b> |             |
|---|---|-------------|
|   | <b>2012</b>                                 | <b>2011</b> |
| Net revenue:  |   |             |
| Products  | \$ 40,628                                   | \$ 56,174   |
| Services  | 42,120                                      | 43,401      |
| Other   |   | 876         |
| Total net revenue   | 82,748                                      | 100,451     |
| Cost of revenue:  |   |             |
| Cost of products  | 24,009                                      | 38,373      |
| Cost of services  | 35,063                                      | 37,349      |
| Cost of other   |   | 301         |
| Total cost of revenue   | 59,072                                      | 76,023      |
| Gross profit  | 23,676                                      | 24,428      |
| Operating expenses:   |   |             |
| Selling and marketing   | 12,889                                      | 13,581      |
| Research and development  | 20,209                                      | 20,565      |
| General and administrative  | 13,269                                      | 14,969      |
| Impairment of indefinite lived intangible asset                     | 12,200                                      |             |
| Total operating expenses  | 58,567                                      | 49,115      |
| Loss from operations  | (34,891)                                    | (24,687)    |
| Other income (expense), net   | (747)                                       | (2,858)     |
| Loss before provision for income taxes                              | (35,638)                                    | (27,545)    |
| Provision for income taxes  | 597   | 538         |
| Net loss  | (36,235)                                    | (28,083)    |
| Net loss attributable to non-controlling interest                   | (12,105)                                    | (1,573)     |
| Net loss attributable to stockholders                               | \$ (24,130)                                 | \$ (26,510) |
| Net loss per share attributable to stockholders                     |   |             |
| Basic and diluted   | \$ (0.34)                                   | \$ (0.38)   |
| Weighted average common shares used in computing net loss per share |   |             |
| Basic and diluted   | 71,995                                      | 70,263      |
| Net loss attributable to stockholders                               | \$ (24,130)                                 | \$ (26,510) |
| Foreign currency translation adjustment                             | (535)                                       | 835         |
| Comprehensive loss  | \$ (24,665)                                 | \$ (25,675) |

*The accompanying notes are an integral part of these condensed consolidated financial statements.*

Table of Contents**Accuray Incorporated****Condensed Consolidated Statements of Cash Flows**

(in thousands)

(Unaudited)

|  | <b>Three Months Ended<br/>September 30,</b> |             |
|--|---|-------------|
|  | <b>2012</b>                                 | <b>2011</b> |
| <b>Cash Flows From Operating Activities</b>                                |   |             |
| Net loss   | \$ (36,235)                                 | \$ (28,083) |
| Adjustments to reconcile net loss to net cash used in operating activities |   |             |
| Depreciation and amortization  | 7,827                                       | 8,319       |
| Impairment of indefinite lived intangible asset                            | 12,200                                      |             |
| Share-based compensation   | 1,755                                       | 2,609       |
| Accretion of interest on long-term debt                                    | 1,041                                       | 639         |
| Provision for (recovery of) bad debt                                       | 73  | (454)       |
| Provision for write-down of inventories                                    | 375   | 1,578       |
| Gain on previously held equity interest in Morphormics                     | (662)                                       |             |
| Changes in assets and liabilities:   |   |             |
| Restricted cash  | (1,050)                                     | (112)       |
| Accounts receivable  | 10,769                                      | (16,659)    |
| Inventories  | (320)                                       | 11,545      |
| Prepaid expenses and other current assets                                  | (3,673)                                     | 2,579       |
| Deferred cost of revenue   | (322)                                       | (3,726)     |
| Accounts payable   | 9,805                                       | (14,010)    |
| Accrued liabilities  | (14,872)                                    | (19,657)    |
| Customer advances  | 2,834                                       | (1,647)     |
| Deferred revenue   | (2,707)                                     | 7,763       |
| Net cash used in operating activities                                      | (13,162)                                    | (49,316)    |
| <b>Cash Flows From Investing Activities</b>                                |   |             |
| Purchases of property and equipment, net                                   | (5,319)                                     | (995)       |
| Purchase of intangible asset   | (232)                                       |             |
| Acquisition of business, net of cash acquired                              | (3,861)                                     | (1,384)     |
| Net cash used in investing activities                                      | (9,412)                                     | (2,379)     |
| <b>Cash Flows From Financing Activities</b>                                |   |             |
| Proceeds from issuance of common stock                                     | 251   | 911         |
| Proceeds from debt, net of costs   |   | 96,100      |
| Net cash provided by financing activities                                  | 251   | 97,011      |
| Effect of exchange rate changes on cash and cash equivalents               | 680   | (1,072)     |
| Net increase (decrease) in cash and cash equivalent                        | (21,643)                                    | 44,244      |
| Cash and cash equivalents at beginning of period                           | 143,504                                     | 95,906      |
| Cash and cash equivalents at end of period                                 | \$ 121,861                                  | \$ 140,150  |

*The accompanying notes are an integral part of these condensed consolidated financial statements.*

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**Accuray Incorporated**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**1. Summary of Significant Accounting Policies**

**Description of Business**

Accuray Incorporated (together with its subsidiaries, the Company) is incorporated in Delaware. The Company designs, develops and sells advanced radiosurgery and radiation therapy systems for the treatment of tumors throughout the body.

**Basis of Presentation and Principles of Consolidation**

The condensed consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries and a variable interest entity, Compact Particle Acceleration Corporation (CPAC) (for further information, see Note 9, Investment in CPAC). All significant inter-company transactions and balances have been eliminated in consolidation.

The accompanying condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles, (GAAP), pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). Certain information and note disclosures have been condensed or omitted pursuant to such rules and regulations. The unaudited condensed consolidated financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary for a fair presentation of the periods presented. The results for the three months ended September 30, 2012 are not necessarily indicative of the results to be expected for the year ending June 30, 2013, for any other interim period or for any future year.

**Use of Estimates**

The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures at the date of the financial statements. Key estimates and assumptions made by the Company relate to revenue recognition, business combination and intangible asset impairment, inventories, share-based compensation expense, income taxes, loss contingencies and corporate bonus expenses and accruals. Actual results could differ materially from those estimates.



### **Concentration of Credit and Other Risks**

The Company's cash and cash equivalents are mainly deposited with several major financial institutions. At times, deposits in these institutions exceed the amount of insurance provided on such deposits. The Company has not experienced any losses in such accounts and believes that it is not exposed to any significant risk on these balances.

For the three months ended September 30, 2012 and 2011, there were no customers that represented 10% or more of total net revenue. At September 30, 2012 and June 30, 2012, there were no customers and two customers, respectively, whose accounts receivable balance was 10% or more of the Company's total accounts receivable.

Accounts receivable are typically not collateralized. The Company performs ongoing credit evaluations of its customers and maintains reserves for potential credit losses. Accounts receivable are deemed past due in accordance with the contractual terms of the agreement. Accounts are charged against the allowance for doubtful accounts once collection efforts are unsuccessful. Historically, such losses have been within management's expectations.

Single source suppliers presently provide the Company with several components. In most cases, if a supplier was unable to deliver these components, the Company believes that it would be able to find other sources for these components subject to any regulatory qualifications, if required.

### **Revenue Recognition**

The Company earns revenue from the sale of products, the operation of its shared ownership program, and the provision of related services, which include installation services, post-contract customer support ( PCS ), training and other professional services. The Company records its revenues net of any value added or sales tax. For arrangements with multiple elements, the Company allocates arrangement fees to product and services based upon Vendor Specific Objective Evidence ( VSOE ) of fair value of the respective elements, or Third-Party Evidence ( TPE ), or Best Estimate of Selling Price ( BESP ), using the relative selling price method.

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*Product Revenue*

The majority of product revenue is generated from sales of CyberKnife and TomoTherapy systems. The Company sells its systems with PCS contracts, training, and at times, professional services. PCS contracts provide planned and corrective maintenance services, software updates, bug fixes, as well as call-center support. If the Company is responsible for installation, the Company recognizes revenue after installation and acceptance of the system. Otherwise, revenue is recognized upon delivery.

*Service Revenue*

Service revenue is generated primarily from PCS (warranty period services and post warranty services), installation services, training, and professional services. PCS revenue is deferred and recognized over the service period. Installation service revenue is recognized concurrent with system revenue. Training and professional service revenues that are not deemed essential to the functionality of the systems are recognized as such services are performed.

Costs associated with service revenue are expensed when incurred, except when those costs are related to system upgrades where revenue recognition has been deferred. In those cases, the costs are deferred and are recognized over the period of revenue recognition.

*Shared ownership program*

The Company also enters into arrangements under its shared ownership program with certain customers. These arrangements typically have a term of five years and provide the customer an option to purchase the system during the contractual term at pre-determined prices. Under the terms of this program, the Company retains title to its system, while the customer has use of the system. The Company generally receives a minimum monthly payment and earns additional revenues from the customer based upon its use of the system which are included in product revenue in the condensed consolidated statements of operations and comprehensive loss.

*Other revenue*

Other revenue primarily consists of research and development and construction contract revenues.

*Long-term construction and manufacturing contracts*

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The Company recognizes revenue and cost of revenue related to long-term construction and manufacturing contracts using contract accounting on the percentage-of-completion or the completed contract method. The Company records such revenue under other revenue and cost of such revenue under cost of other revenue in the condensed consolidated statements of operations and comprehensive loss. Any loss provision identified from the total contract in the period is recorded as an increase to cost of revenue.

### Net Loss Per Common Share

Basic and diluted net loss per share is computed by dividing net loss attributable to stockholders by the weighted average number of common shares outstanding during the period. The potential dilutive shares of the Company's common stock resulting from the assumed exercise of outstanding stock options, the vesting of Restricted Stock Units (RSUs) and Performance-based Stock Units (PSUs), and the purchase of shares under the Employee Stock Purchase Plan (ESPP), as determined under the treasury stock method, are excluded from the computation of diluted net loss per share because their effect would have been anti-dilutive.

A reconciliation of the numerator and denominator used in the calculation of basic and diluted net loss per share attributable to stockholders follows (in thousands):

|  | <b>Three Months Ended<br/>September 30,</b> |             |
|--|---|-------------|
|  | <b>2012</b>                                 | <b>2011</b> |
| <b>Numerator:</b>  |   |             |
| Net loss used in computing basic and diluted net loss per share      | \$ (24,130)                                 | \$ (26,510) |
| <b>Denominator:</b>  |   |             |
| Weighted average shares used in computing basic net loss per share   | 71,995                                      | 70,263      |
| Add: Dilutive stock options and awards outstanding                   |   |             |
| Weighted average shares used in computing diluted net loss per share | 71,995                                      | 70,263      |

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The following table sets forth all potentially dilutive securities excluded from the computation in the table above because their effect would have been anti-dilutive (in thousands):

|               |       | As at<br>September 30, |  |
|---------------|-------|------------------------|--|
|               | 2012  | 2011                   |  |
| Stock options | 7,703 | 8,191                  |  |
| RSUs and PSUs | 2,007 | 1,591                  |  |
|               | 9,710 | 9,782                  |  |

The 3.75% Convertible Senior Notes due August 1, 2016 (the "Convertible Notes") are included in the calculation of diluted net income per share if their inclusion is dilutive under the if-converted method. For the three months ended September 30, 2012, the potential dilutive shares under the Convertible Notes were excluded from the calculation of diluted net loss per share as their inclusion would be anti-dilutive.

## Segment Information

The Company has determined that it operates in only one segment, as it only reports profit and loss information on an aggregate basis to its chief operating decision maker. The Company's long-lived assets maintained outside the United States are not material. Revenue by geographic region is based on the shipping addresses of the Company's customers. The following summarizes revenue by geographic region (in thousands):

|                                       |           | Three Months Ended<br>September 30, |  |
|---------------------------------------|-----------|-------------------------------------|--|
|                                       | 2012      | 2011                                |  |
| Americas                              | \$ 35,811 | \$ 48,849                           |  |
| Europe, Middle East, India and Africa | 25,118    | 28,615                              |  |
| Asia (excluding Japan)                | 15,121    | 16,157                              |  |
| Japan                                 | 6,698     | 6,830                               |  |
| Total                                 | \$ 82,748 | \$ 100,451                          |  |

## 2. Balance Sheet Components

### Accounts receivable, net

Accounts receivable, net consisted of the following (in thousands):

|                     | September 30,<br>2012 | June 30,<br>2012 |  |
|---------------------|-----------------------|------------------|--|
| Accounts receivable | \$ 59,167             | \$ 69,285        |  |

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|                                       |           |           |
|---------------------------------------|-----------|-----------|
| Unbilled fees and services            | 226       | 305       |
|                                       | 59,393    | 69,590    |
| Less: Allowance for doubtful accounts | (1,773)   | (1,700)   |
| Accounts receivable, net              | \$ 57,620 | \$ 67,890 |

## *Financing receivables*

A financing receivable is a contractual right to receive money, on demand or on fixed or determinable dates, that is recognized as an asset in the creditor's balance sheet. The Company's financing receivables, consisting of its accounts receivable with contractual maturities of more than one year, was \$5.6 million and \$2.5 million at September 30, 2012 and June 30, 2012, respectively and are included in Other Assets in the condensed consolidated balance sheets. There was no balance in the allowance for doubtful financing receivable accounts as of September 30 and June 30, 2012.

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Inventories consisted of the following (in thousands):

|                 | September 30,<br>2012 |    | June 30,<br>2012 |
|-----------------|-----------------------|----|------------------|
| Raw materials   | \$ 34,719             | \$ | 34,579           |
| Work-in-process | 16,541                |    | 16,547           |
| Finished goods  | 30,479                |    | 30,567           |
| Inventories     | \$ 81,739             | \$ | 81,693           |

**Property and equipment, net**

Property and equipment, net consisted of the following (in thousands):

|   | September 30,<br>2012 |    | June 30,<br>2012 |
|---|-----------------------|----|------------------|
| Furniture and fixtures                          | \$ 5,966              | \$ | 5,921            |
| Computer and office equipment                   | 9,452                 |    | 9,126            |
| Software  | 9,409                 |    | 9,429            |
| Leasehold improvements                          | 16,340                |    | 16,065           |
| Machinery and equipment                         | 33,536                |    | 33,493           |
| Shared ownership systems                        | 4,979                 |    | 4,979            |
| Construction in progress                        | 8,794                 |    | 3,787            |
|   | 88,476                |    | 82,800           |
| Less: Accumulated depreciation and amortization | (48,940)              |    | (45,342)         |
| Property and equipment, net                     | \$ 39,536             | \$ | 37,458           |

Depreciation expense related to property and equipment for the three months ended September 30, 2012 and 2011 was \$4.1 million and \$4.2 million, respectively.

**3. Goodwill and Intangible Assets***Goodwill*

Activity related to goodwill consisted of the following (in thousands):

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|   | Three Months<br>Ended<br>September 30,<br>2012 | Year Ended<br>June 30,<br>2012 |
|---|--|--------------------------------|
| Balance at the beginning of the period            | \$ 59,215                                      | \$ 54,474                      |
| Addition related to acquisition                   | 77   |                                |
| Currency translation and other adjustments        | 52   |                                |
| Adjustments related to prior year acquisition (1) |  | 4,741                          |
| Balance at the end of the period                  | \$ 59,344                                      | \$ 59,215                      |

(1) Primarily represents liabilities related to the TomoTherapy acquisition.

*Intangible Assets*

The Company's intangible assets associated with completed acquisitions at September 30, 2012 and June 30, 2012 are as follows (in thousands):

|   |                            | September 30, 2012          |                       |                             |               | June 30, 2012               |                             |               |
|---|----------------------------|-----------------------------|-----------------------|-----------------------------|---------------|-----------------------------|-----------------------------|---------------|
|   | Useful Lives<br>(in years) | Gross<br>Carrying<br>Amount | Impairment<br>Charges | Accumulated<br>Amortization | Net<br>Amount | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Amount |
| Developed technology                          | 5 - 6                      | \$ 48,556                   | \$                    | \$ (11,136)                 | \$ 37,420     | \$ 43,455                   | \$ (9,161)                  | \$ 34,294     |
| Backlog                                       | 1.25                       | 10,500                      |                       | (10,500)                    |               | 10,500                      | (8,867)                     | 1,633         |
| Distributor license                           | 1.5 - 2.5                  | 2,091                       |                       | (989)                       | 1,102         | 1,860                       | (768)                       | 1,092         |
| In-process research and<br>development (CPAC) | Indefinite                 | 12,800                      | (12,200)              |                             | 600           | 12,800                      |                             | 12,800        |
|   |                            | \$ 73,947                   | \$ (12,200)           | \$ (22,625)                 | \$ 39,122     | \$ 68,615                   | \$ (18,796)                 | \$ 49,819     |

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At September 30, 2012, the Company noted certain impairment triggers based on results of research and development work carried out by CPAC. As a result, based on projected future usage of the in-process research and development ( IPR&D ) technology by CPAC, an impairment charge of \$12.2 million was recorded during the three months ended September 30, 2012. The Company did not identify any impairment triggers on goodwill or any of its definite intangible and long-lived assets.

Amortization expense related to intangible assets was \$3.8 million and \$4.1 million for the three months ended September 30, 2012 and 2011, respectively.

The estimated future amortization expense of purchased intangible assets, excluding in-process research and development, as of September 30, 2012 is as follows (in thousands):

| <b>Year Ending June 30,</b> | <b>Amount</b> |
|-----------------------------|---------------|
| 2013 (remaining 9 months)   | \$ 6,610      |
| 2014                        | 8,395         |
| 2015                        | 7,953         |
| 2016                        | 7,953         |
| 2017                        | 7,568         |
| Thereafter                  | 43            |
|                             | \$ 38,522     |

**4. Financial Instruments**

The following tables summarize the fair value of assets measured on a recurring basis as of September 30, 2012 and June 30, 2012 (in thousands):

| Type of instrument and line item in condensed consolidated balance sheets | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Instruments<br>(Level 1) | Fair value measurement using                           |   | Total<br>balance |
|---|--|--|---|------------------|
|   |  | Significant<br>Other<br>Observable<br>Inputs (Level 2) | Significant<br>Unobservable<br>Inputs (Level 3) |                  |
| Assets at September 30, 2012  |  |  |   |                  |
| Money market funds - included in cash and cash equivalents                | \$ 20,080  | \$   | \$  | \$ 20,080        |
| Certificate of deposits - included in cash and cash equivalents           | \$ 9,775   | \$   | \$  | \$ 9,775         |
| Assets at June 30, 2012   |  |  |   |                  |
| Money market funds - included in cash and cash equivalents                | \$ 40,068  | \$   | \$  | \$ 40,068        |
| Certificate of deposits - included in cash and cash equivalents           | \$ 6,742   | \$   | \$  | \$ 6,742         |



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The following tables summarize the fair value of financial instruments that are not measured on a recurring basis as of September 30, 2012 and June 30, 2012 (in thousands):

| Type of instrument and line item in condensed consolidated balance sheets | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Instruments<br>(Level 1) | Fair value measurement using                           |   |    | Total<br>balance |
|---|--|--|---|----|------------------|
|   |  | Significant<br>Other<br>Observable<br>Inputs (Level 2) | Significant<br>Unobservable<br>Inputs (Level 3) |    |                  |
| At September 30, 2012   |  |  |   |    |                  |
| Long-term debt  | \$   | \$ 103,900   | \$  | \$ | 103,900          |
| At June 30, 2012  |  |  |   |    |                  |
| Long-term debt  | \$   | \$ 101,400   | \$  | \$ | 101,400          |

The long-term debt is measured on a non-recurring basis using Level 2 inputs based upon observable inputs of the Company's underlying stock price and the time value of the conversion option, since an observable quoted price of the Convertible Notes is not readily available.

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**5. Contingencies**

**Litigation**

From time to time, the Company is involved in legal proceedings arising in the ordinary course of its business. Currently, management believes the Company does not have any probable and estimable loss related to any current legal proceedings and claims that would individually or in the aggregate materially adversely affect its financial condition or operating results. Litigation is inherently unpredictable and is subject to significant uncertainties, some of which are beyond the Company's control. Should any of these estimates and assumptions change or prove to have been incorrect, the Company could incur significant charges related to legal matters which could have a material impact on its results of operations, financial position and cash flows.

***Best Medical Trade Secret Litigation***

On September 3, 2009, Best Medical International, Inc. ( "Best Medical" ) filed a lawsuit against the Company in the U.S. District Court for the Western District of Pennsylvania, claiming that the Company induced certain individuals to leave the employment of Best Medical and join the Company in order to gain access to Best Medical's confidential information and trade secrets. Best Medical is seeking monetary damages and other relief. The Company filed a motion for summary judgment on May 20, 2011, Best Medical filed its response on June 21, 2011, and the Company filed a response to their response on July 8, 2011. On October 25, 2011, the court granted summary judgment in favor of the Company on all counts. On November 21, 2011 Best Medical filed a notice of appeal, and the parties await a ruling by the appellate court. At this time, the Company does not have enough information to estimate what, if any, financial impact this claim will have.

***Best Medical Patent Litigation***

On August 6, 2010, Best Medical filed an additional lawsuit against the Company in the U.S. District Court for the Western District of Pennsylvania, claiming that the Company has infringed U.S. Patent No. 5,596,619, a patent that Best Medical alleges protects a method and apparatus for conformal radiation therapy. On December 2, 2010, the Court granted the Company's motion to dismiss, with leave to amend. On December 16, 2010, Best Medical filed an amended complaint, claiming that the Company also infringed U.S. Patent Nos. 6,038,283 and 7,266,175, both of which Best Medical alleges cover methods and apparatus for conformal radiation therapy. On March 9, 2011, the Court dismissed with prejudice all counts against the Company, except for two counts of alleged willful infringement of two of the patents. The Court issued a Scheduling Order on May 12, 2011 appointing a special master for claim construction, and setting a claim construction hearing on January 10, 2012. Best Medical moved to voluntarily dismiss one of the two remaining patent claims on June 28, 2011, which the court granted on June 30, 2011, leaving only one patent (U.S. Patent No. 6,038,283) at issue in the case. The Court held a claim construction hearing on May 16, 2012, and the Company believes the court will issue a claim construction order sometime in December 2012 or January 2013. Best Medical is seeking declaratory and injunctive relief, as well as unspecified compensatory and treble damages and other relief. At this time, the Company does not have enough information to estimate what, if any, financial impact this claim will have.

***Rotary Systems***

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On April 28, 2011, a former supplier to TomoTherapy, Rotary Systems Incorporated, filed suit in Minnesota state court, Tenth Judicial District, Anoka County, against TomoTherapy alleging misappropriation of trade secrets, as well as several other counts alleging various theories of injury. Rotary Systems alleges TomoTherapy misappropriated Rotary Systems' trade secrets pertaining to a component previously purchased from Rotary Systems, which component TomoTherapy now purchases from a different supplier. The suit alleges TomoTherapy improperly supplied the alleged trade secrets to its present supplier, Dynamic Sealing Technologies Inc. (also a named defendant in the suit). Rotary Systems has made an unspecified claim for damages of greater than \$50,000. TomoTherapy moved to dismiss the case on May 19, 2011,

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and on August 29, 2011, the court granted the motion to dismiss with respect to all counts other than the count alleging misappropriation of trade secrets. On May 21, 2012, the court granted the Company's motion for sanctions, in part, and gave Rotary Systems sixty days to identify the alleged trade secrets with specificity or face dismissal of its claim with prejudice. The court held a hearing on September 20, 2012, and the Company awaits the court's ruling. At this time, the Company does not have enough information to estimate what, if any, financial impact this claim will have.

***Radiation Stabilization Solutions Patent Litigation***

On September 15, 2011, Radiation Stabilization Solutions LLC (RSS) filed a patent infringement complaint in the United States District Court for the Northern District of Illinois, Eastern Division. The complaint, alleged the Company's sale of the TomoHD product induces infringement of or contributorily infringes U.S. Patent No. 6,118,848, or the '848 Patent, and sought unspecified monetary damages for the alleged infringement. The complaint also named Varian Medical Systems, Inc., BrainLab AG, BrainLab, Inc., Elekta AB and Elekta, Inc. as defendants, alleging that certain of their products also infringe the '848 patent. On October 27, 2011, the Court dismissed the complaint without prejudice because non-resident defendants had been improperly named in the complaint.

On October 28, 2011, RSS filed a new complaint against the Company and a customer of the Company in the United States District Court for the Northern District of Illinois, Eastern Division. The new complaint repeats the original complaint's allegations against the Company and seeks unspecified monetary damages for the alleged infringement. The complaint further alleges that the customer directly and indirectly infringes the '848 patent, and seeks unspecified monetary damages for the alleged infringement. RSS also filed individual suits against each of Varian and Elekta and several of their respective customers. RSS served the complaint on Accuray and its customer on December 7, 2011. On January 30, 2012 the Company filed a motion to dismiss the complaint, and the Court heard oral argument for the motion on June 29, 2012. On August 21, 2012, the court granted the Company's motion in part and gave RSS leave to amend the complaint. On September 21, 2012, RSS filed an amended complaint. On November 2, 2012, the Company and RSS entered into a settlement agreement, under which the Company will pay \$150,000 to resolve all outstanding claims.

***Accuray Securities Complaint***

On November 1, 2012, a complaint was filed in Santa Clara County Superior Court purportedly on behalf of a class of shareholders seeking to enjoin the shareholder vote to be held at our annual meeting scheduled for November 30, 2012. The complaint names as defendants the Company and the members of the board of directors and alleges that the disclosures in the proxy statement for the annual meeting concerning the advisory vote on executive compensation and the proposal to amend the certificate of incorporation to increase the number of authorized shares are inadequate and constitute a breach of fiduciary duty. In addition to an injunction, the complaint seeks unspecified monetary damages and other relief. At this time, the Company does not have enough information to estimate what, if any, financial impact this complaint will have.

***Software License Indemnity***

Under the terms of the Company's software license agreements with its customers, the Company agrees that in the event the software sold infringes upon any patent, copyright, trademark, or any other proprietary right of a third party, it will indemnify its customer licensees against any loss, expense, or liability from any damages that may be awarded against its customer. The Company includes this infringement

indemnification in all of its software license agreements and selected managed services arrangements. In the event the customer cannot use the software or service due to infringement and the Company cannot obtain the right to use, replace or modify the license or service in a commercially feasible manner so that it no longer infringes, then the Company may terminate the license and provide the customer a refund of the fees paid by the customer for the infringing license or service. The Company has not recorded any liability associated with this indemnification, as it is not aware of any pending or threatened actions that represent probable losses as of September 30, 2012.

## 6. Acquisition

On July 16, 2012, the Company acquired the remaining 90% of the outstanding shares of Morphormics, Inc. ( Morphormics ), a privately-held developer of medical imaging software based in North Carolina. The purpose of this acquisition was to enable the Company to extend auto-contouring capabilities for both the CyberKnife and TomoTherapy systems to improve disease specific workflows. The Company previously held 10% of the outstanding shares of Morphormics which was carried at zero value prior to the acquisition and re-measured to its acquisition-date fair value of \$0.7 million based on the fair value of the consideration transferred. As a result, the Company recognized a gain of \$0.7 million in other income (expense), net, during the three months ended September 30, 2012. The acquisition has been accounted for as a business combination using purchase accounting and Morphormics' results of operations are included in the condensed consolidated financial statements from July 16, 2012. The acquisition was not considered a material business combination and was funded through cash on-hand. As per the acquisition agreement, \$0.9 million of the purchase consideration is to be paid on April 16, 2013 and is included in other accrued liabilities in the condensed consolidated balance sheet at September 30, 2012. The Company has not incurred material severance or acquisition-related costs.

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The fair value of total purchase consideration paid and payable for 100% of Morphormics' equity interest as of the acquisition date was as follows (in thousands):

|  |           |              |
|--|-----------|--------------|
| Cash paid and payable                                | \$        | 5,385        |
| Fair value of pre-existing investment in Morphormics |           | 662          |
| <b>Total</b>   | <b>\$</b> | <b>6,047</b> |

The total purchase price was allocated to the net tangible and intangible assets acquired and liabilities assumed based on their fair values as of the acquisition date as follows (in thousands):

|  |           |              |
|--|-----------|--------------|
| Cash and cash equivalents                            | \$        | 668          |
| Accounts receivable                                  |           | 283          |
| Other current assets                                 |           | 7            |
| Amortizable intangible assets - developed technology |           | 5,100        |
| Goodwill   |           | 77           |
| Accrued compensation                                 |           | (88)         |
| <b>Total purchase price</b>                          | <b>\$</b> | <b>6,047</b> |

Developed technology represents the fair value of Morphormics' imaging software product which is being amortized on a straight-line basis over an estimated life of 5 years.

Pro forma results of operations for the acquisition have not been presented because it is not material to the Company's condensed consolidated statements of operations and comprehensive loss, balance sheets, or cash flows.

## 7. Share-Based Compensation

The following table summarizes the share-based compensation charges included in the Company's condensed consolidated statements of operations and comprehensive loss (in thousands):

|                            | <b>Three Months Ended September 30,</b> |                 |
|----------------------------|---|-----------------|
|                            | <b>2012</b>                             | <b>2011</b>     |
| Cost of revenue            | \$ 247                                  | \$ 558          |
| Selling and marketing      | 220                                     | 229             |
| Research and development   | 516                                     | 602             |
| General and administrative | 772                                     | 1,220           |
|                            | <b>\$ 1,755</b>                         | <b>\$ 2,609</b> |

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At September 30, 2012 and June 30, 2012, capitalized share-based compensation expenses of \$0.4 million were included as a component of inventories.

### *Performance-Based Awards*

During fiscal 2012, the Compensation Committee of the Board of Directors of the Company approved the granting of PSUs to employees of the Company which vest only upon meeting certain financial performance criteria during the performance period commencing on the first day of the Company's 2012 fiscal year and ending on the last day of the Company's 2013 fiscal year. If the PSUs do not become vested as a result of the Company's performance during the performance period, all PSUs are automatically forfeited by the participants effective as of the last day of the performance period. During fiscal 2012, approximately 1.0 million PSUs were granted to employees valued at approximately \$3.9 million which was based on the fair value of the Company's common stock on the grant date and will be recognized over the requisite performance period based on management's assessment of the probability of achieving the performance criteria. Approximately 0.9 million PSUs are outstanding as of September 30, 2012.

As of September 30, 2012, management assessed that it was not probable that the performance criteria would be met during the performance period and accordingly, no compensation cost has been recognized for the PSUs to date or during the three months ended September 30, 2012. If in a future period management revises its assessment and concludes that it is probable that the performance criteria will be met, the Company will record a cumulative catch up compensation charge for the PSUs in that period. Remaining compensation charges would be recognized ratably over the remaining performance period.

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**8. Debt**

On August 1, 2011, the Company issued the Convertible Notes to certain qualified institutional buyers or QIBs. The Convertible Notes were offered and sold to the QIBs pursuant to Rule 144A under the Securities Act of 1933, as amended. The net proceeds from the \$100 million offering, after deducting the initial purchaser's discount and commission and the related offering costs, were approximately \$96.1 million. The offering costs and the initial purchaser's discount and commission (which are recorded in Other Assets) are both being amortized to interest expense using the effective interest method over five years. The Convertible Notes bear interest at a rate of 3.75% per year, payable semi-annually in arrears in cash on February 1 and August 1 of each year, beginning on February 1, 2012. The Convertible Notes will mature on August 1, 2016, unless earlier repurchased, redeemed or converted.

The Convertible Notes were issued under an Indenture between the Company and The Bank of New York Mellon Trust Company, N.A., as trustee. Holders of the Convertible Notes may convert their Convertible Notes at any time on or after May 1, 2016 until the close of business on the business day immediately preceding the maturity date. Prior to May 1, 2016, holders of the Convertible Notes may convert their Convertible Notes only under the following circumstances: (1) during any calendar quarter after the calendar quarter ending September 30, 2011, and only during such calendar quarter, if the closing sale price of the Company's common stock for each of 20 or more trading days in the 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the conversion price in effect on the last trading day of the immediately preceding calendar quarter; (2) during the five consecutive business days immediately after any five consecutive trading-day period (such five consecutive trading-day period, the "Note Measurement Period") in which the trading price per \$1,000 principal amount of Convertible Notes for each trading day of that Note Measurement Period was equal to or less than 98% of the product of the closing sale price of shares of the Company's common stock and the applicable conversion rate for such trading day; (3) if the Company calls any or all of the Convertible Notes for redemption, at any time prior to the close of business on the business day immediately preceding the redemption date; or (4) upon the occurrence of specified corporate transactions as described in the Indenture. Upon conversion by holders of the Convertible Notes, the Company will have the right to pay or deliver, as the case may be, cash, shares of common stock of the Company or a combination thereof, at the Company's election. At any time on or prior to the 33rd business day immediately preceding the maturity date, the Company may irrevocably elect to (a) deliver solely shares of common stock of the Company in respect of the Company's conversion obligation or (b) pay cash up to the aggregate principal amount of the Convertible Notes to be converted and pay or deliver, as the case may be, cash, shares of common stock of the Company or a combination thereof in respect of the remainder, if any, of the Company's conversion obligation in excess of the aggregate principal amount of the Convertible Notes being converted. The initial conversion rate is 105.5548 shares of the Company's common stock per \$1,000 principal amount of Convertible Notes (which represents an initial conversion price of approximately \$9.47 per share of the Company's common stock). The conversion rate, and thus the conversion price, are subject to adjustment as further described below.

Holders of the Convertible Notes who convert their Convertible Notes in connection with a "make-whole fundamental change", as defined in the Indenture, may be entitled to a make-whole premium in the form of an increase in the conversion rate. Additionally, in the event of a fundamental change, as defined in the Indenture, holders of the Convertible Notes may require the Company to purchase all or a portion of their Convertible Notes at a fundamental change repurchase price equal to 100% of the principal amount of Convertible Notes, plus accrued and unpaid interest, if any, to, but not including, the fundamental change repurchase date.

On or after August 1, 2014 and prior to the maturity date, the Company may redeem for cash all or a portion of the Convertible Notes if the closing sale price of its common stock exceeds 130% of the applicable conversion price (the initial conversion price is approximately \$9.47 per share of common stock) of such Convertible Notes for at least 20 trading days during any consecutive 30 trading-day period (including the last trading day of such period).



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In accordance with Accounting Standards Codification ( ASC ) 470-20 Debt with Conversion and Other Options, the Company separately accounts for the liability and equity conversion components of the Convertible Notes. The principal amount of the liability component of the Convertible Notes was \$75.9 million as of the date of issuance based on the present value of its cash flows using a discount rate of 10%, our approximate borrowing rate at the date of the issuance for a similar debt instrument without the conversion feature. The carrying value of the equity conversion component was \$24.1 million. A portion of the initial purchaser's discount and commission and the offering costs totaling \$0.9 million was allocated to the equity conversion component. The liability component will be accreted to the principal amount of the Convertible Notes using the effective interest method over five years.

The following table presents the carrying value of the Convertible Notes as of September 30, 2012 (in thousands):

|  |    |          |
|--|----|----------|
| Carrying amount of the equity conversion component | \$ | 23,189   |
| Principal amount of the Convertible Notes          | \$ | 100,000  |
| Unamortized debt discount (1)                      |    | (19,493) |
| Net carrying amount                                | \$ | 80,507   |

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(1)As of September 30, 2012, the remaining period over which the unamortized debt discount will be amortized is 46 months.

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A summary of interest expense and effective interest rate on the liability component related to the Convertible Notes for the three months ended September 30, 2012 and 2011 was as follows (in thousands):

|   | Three months ended<br>September 30, 2012 |       | Three months ended<br>September 30, 2011 |       |
|---|--|-------|--|-------|
| Effective interest rate                                   |  | 10.0% |  | 10.0% |
| Interest expense related to contractual interest coupon   | \$                                       | 938   | \$                                       | 625   |
| Interest expense related to amortization of debt discount |  | 1,041 |  | 639   |
| Total interest expense recognized                         | \$                                       | 1,979 | \$                                       | 1,264 |

**9. Investment in CPAC**

In April 2008, TomoTherapy established a new affiliate, CPAC, to develop a compact proton therapy system for the treatment of cancer. As its initial investment in CPAC, TomoTherapy contributed intellectual property with a fair market value of approximately \$1.9 million. Since then, CPAC has raised additional funds from TomoTherapy, the Company and other investors through the sale of stock and issuance of promissory notes. As of September 30, 2012, the Company and its wholly owned subsidiary, TomoTherapy, together own approximately 15.4% of the outstanding stock of CPAC and approximately 16.3% on a fully diluted basis. Although TomoTherapy's and the Company's combined ownership in CPAC is less than 50%, the Company includes CPAC in its condensed consolidated financial statements because the Company and TomoTherapy are the primary beneficiaries of CPAC (a variable interest entity, or VIE). The Company and TomoTherapy were involved in the design of CPAC, from which CPAC cannot depart due to restrictions that are part of its financing arrangements. The Company also provided intellectual property, which is the basis of CPAC and also holds influence over the VIE through representation on CPAC's board of directors. Further, the Company has an option to either acquire CPAC or enter into a distribution arrangement for the technology developed by CPAC as further described below. CPAC's outside stockholders' interests are shown in the Company's condensed consolidated financial statements as Non-controlling interest. The liabilities of the VIE do not represent additional claims on the Company's general assets; rather they represent claims against the specific assets of the VIE. Likewise, the assets of the VIE consolidated by the Company do not represent additional assets available to satisfy claims against the Company's general assets. The creditors of the VIE do not have recourse to the Company. Total assets and liabilities of CPAC were \$2.4 million and \$2.2 million, respectively, as of September 30, 2012 and \$15.0 million and \$0.6 million, respectively, as of June 30, 2012, which are included within the Company's condensed consolidated balance sheets. See Note 3, Goodwill and Intangible Assets for details of the impairment charge recorded for CPAC's in-process research and development intangible asset in the three months ended September 30, 2012.

From December 2010 through March 2012, the Company, TomoTherapy and certain other CPAC investors purchased convertible promissory notes from CPAC. Total consideration for the notes that the Company and TomoTherapy purchased was \$1.2 million. Under the terms of the December 2010 notes, TomoTherapy received warrants for 1,386,981 common shares of CPAC. Other participating investors also purchased \$3.3 million of the convertible notes which were included in other accrued liabilities in the Company's condensed consolidated balance sheets prior to their conversion to equity in April 2012. The other investors also received warrants under the terms of the December 2010 notes for an aggregate of 1,386,983 shares of CPAC, which were equity classified. The notes bore interest at 12% and were convertible based on a per share conversion price as defined in the notes. The CPAC warrants described above are exercisable through November 2020 at an exercise price of \$0.57 per CPAC common share. At September 30, 2012, none of these warrants had been exercised.

On March 9, 2011, TomoTherapy entered into a revolving promissory note with CPAC. On May 10, 2011, the revolving note was amended to increase the maximum amount available to borrow to \$1.9 million. As of September 30, 2012, \$2.3 million of principal and accrued interest was outstanding under the revolving note. The revolving note bears interest at 12% per annum compounded quarterly. This note and related interest is eliminated in consolidation.

On April 20, 2012, the Company entered into various transactions with CPAC and its other stockholders pursuant to which the Company invested \$1.1 million and also converted the outstanding principal and accrued interest on its convertible promissory notes, amounting to \$1.3 million, into preferred stock. The other note holders also converted their outstanding principal and accrued interest, amounting to \$3.6 million into preferred stock. Certain other investors also participated in the financing. In connection with such transactions, the Company received warrants for 338,839 common shares of CPAC. These warrants are exercisable through April 2017 at an exercise price of \$0.8725 per CPAC common share. At September 30, 2012, none of these warrants had been exercised. The \$1.9 million principal amount revolving promissory note remains outstanding but its maturity date was extended from December 31, 2011 to December 31, 2012 as part of the April 2012 transaction.

In connection with the April 2012 transactions, the Company modified the option it previously held to purchase a portion of the CPAC stock held by other CPAC investors. The Company now has the option, upon the occurrence of certain events, to elect to either acquire CPAC at the then-determined fair value or enter into a non-exclusive supply and distribution agreement for CPAC's compact proton therapy products. The triggers for the option becoming exercisable include CPAC achieving certain technical milestones or the CPAC board approving a proposal for the acquisition of CPAC.

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The Company and CPAC also amended certain licensing relationships for the DWA technology by and between the Company, CPAC and Lawrence Livermore National Security, LLC ( "LLNS" ) and terminated a previous arrangement pursuant to which the Company had provided CPAC with certain accounting and back office support and management services.

In July 2012, some of the participating investors of CPAC purchased convertible notes from CPAC for \$1.3 million. The notes bear interest at 12% per annum and mature on May 31, 2013. The outstanding notes at September 30, 2012 are included in other accrued liabilities in the Company's condensed consolidated balance sheets.

At September 30, 2012, the Company's equity investment in CPAC was \$4.3 million and the outstanding receivables from CPAC were \$2.6 million, which includes \$1.9 million of the principal portion of the revolving promissory note issued by CPAC. The equity investment and the outstanding receivables are eliminated in consolidation. If CPAC is not successful in raising additional funds to continue its development efforts, or if it is not successful in development of the compact proton accelerator technology, or if it is not successful in commercialization of the technology, or if the Company is not in a position to finance its option to purchase CPAC or to become a supplier or distributor of its technology, the Company may need to write down or write off the equity investment and outstanding receivables.

## 10. Subsequent Events

### *Change in Chief Executive Officer*

On October 11, 2012, Dr. Euan S. Thomson, Ph.D. resigned from his positions as President and Chief Executive Officer of the Company. In addition, on October 11, 2012, Dr. Thomson also resigned as a member of the Board of Directors of the Company. In connection with his resignation and separation from the Company in October 2012, the Company and Dr. Thomson entered into a General Release and Separation Agreement (the "Separation Agreement") on October 27, 2012, in accordance with the terms of his employment letter agreement. Dr. Thomson received approximately \$1.2 million of severance related compensation and accelerated vesting of equity awards of approximately \$0.5 million under the Separation Agreement. In addition, the Company and Dr. Thomson entered into a Consulting Services Agreement on October 27, 2012, whereby Dr. Thomson would provide the Company with consulting services in exchange for a monthly consulting fee of \$20,500 for a period of six months.

Effective October 12, 2012, Joshua H. Levine was appointed President and Chief Executive Officer of the Company. Mr. Levine was also appointed as a director of the Company by the Company's Board of Directors effective October 12, 2012 to fill the vacancy created by Dr. Thomson's resignation.

### *Market Stock Unit ( "MSU" ) program*

In October 2012, the Compensation Committee approved a new performance equity program, referred to as the market stock unit program ( "MSU Program" ). The program uses the Russell 2000 index as a performance benchmark and requires that the Company's total stockholder return exceed that of the Russell 2000. Based on a sliding scale of how much the Russell 2000 benchmark is exceeded, participating executives can

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earn up to a maximum of 150% of the target number of shares over two measurement periods, one at the end of fiscal 2014 and another at the end of fiscal 2015.

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**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion and analysis of our financial condition as of September 30, 2012 and results of operations for the three months ended September 30, 2012 and 2011 should be read together with our condensed consolidated financial statements and related notes included elsewhere in this report. Statements made in this Form 10-Q report that are not statements of historical fact are forward-looking statements and are subject to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements in this report relate, but are not limited, to: expectations related to profitability and cash flows in fiscal 2013; sufficiency of cash resources and expected cash flows to fund future operations; expected uses of cash during fiscal 2013; the anticipated drivers of our future capital requirements; the impact of our recent sales reorganization on sales performance, particularly in the United States; anticipated increases in service revenue; the ongoing impact of purchase accounting adjustments; our expectations regarding the factors that will impact sales, competitive positioning and long-term success for our CyberKnife and TomoTherapy Systems; our expectations regarding the impact on our revenues and business of the introduction of our new CyberKnife and TomoTherapy Systems; and the anticipated risks associated with our foreign operations and fluctuations in the U.S. dollar. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from expectations, including risks detailed from time to time under the heading "Risk Factors" in Part II, Item 1A of this report and in Part I, Item 1A of the Company's report on Form 10-K for fiscal year 2012. Forward-looking statements speak only as of the date the statements are made and are based on information available to the Company at the time those statements are made and/or management's good faith belief as of that time with respect to future events. The Company assumes no obligation to update forward-looking statements to reflect actual performance or results, changes in assumptions or changes in other factors affecting forward-looking information, except to the extent required by applicable securities laws. Accordingly, investors should not place undue reliance on any forward-looking statements.*

*In this report, Accuray, the Company, we, us, and our refer to Accuray Incorporated and its subsidiaries.*

**Overview**

**Products and Markets**

We believe we are the premier radiation oncology company based on our history of rapid innovation and our leading edge technologies designed specifically to deliver radiosurgery, stereotactic body radiation therapy, intensity modulated radiation therapy, image guided radiation therapy and adaptive radiation therapy that is tailored to the specific needs of each patient. Our suite of products includes the CyberKnife® Systems and the TomoTherapy® Systems. The systems are highly complementary offerings, serving distinct patient populations treated by the same medical specialty.

The CyberKnife Systems are robotic systems designed to deliver radiosurgery treatments to cancer tumors anywhere in the body. They are the only dedicated, full body radiosurgery systems on the market. Radiosurgery is an alternative to traditional surgery for tumors and is performed on an outpatient basis in one to five treatment sessions. It allows for the treatment of patients who otherwise would not be treated with radiation, who may not be good candidates for surgery, or who desire non-surgical treatments. The use of radiosurgery with CyberKnife Systems to treat tumors throughout the body has grown significantly in recent years, but currently represents only a small portion of the patients who develop tumors treatable with CyberKnife Systems. A determination of when it may or may not be appropriate to use a CyberKnife System for treatment is at the discretion of the treating physician and depends on the specific patient. However, given the CyberKnife Systems' design to treat focal tumors, the CyberKnife Systems are generally not used to treat (1) very large tumors, which are considerably wider than the radiation beam that can be delivered by CyberKnife Systems, (2) diffuse, wide-spread disease, as is often the case for late stage cancers, because they are not localized (though CyberKnife Systems might be used to treat a focal area of the disease) and (3) systemic disease, like leukemias and

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lymphomas, which are not localized to an organ, but rather involve cells throughout the body.

We believe that the long term success of the CyberKnife System is dependent on a number of factors including the following:

- Adoption of our recently launched new CyberKnife platform and receipt of regulatory clearances associated with such new platform;
- Change in medical practice to utilize radiosurgery more regularly as an alternative to surgery or other treatments;
- Greater awareness among doctors and patients of the benefits of radiosurgery with the CyberKnife Systems;
- Continued evolution in clinical studies demonstrating the safety, efficacy and other benefits of using the CyberKnife Systems to treat tumors in various parts of the body;
- Continued advances in technology that improve the quality of treatments and ease of use of the CyberKnife Systems;

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- Improved access to radiosurgery with the CyberKnife Systems in various countries through regulatory approvals;
- Medical insurance reimbursement policies that cover CyberKnife System treatments; and
- Expansion of sales of CyberKnife Systems in countries throughout the world.

The TomoTherapy Systems are advanced, fully integrated and versatile radiation therapy systems for the treatment of a wide range of cancer types. We began selling TomoTherapy Systems after our acquisition of TomoTherapy Incorporated on June 10, 2011. Radiation therapy is used in a variety of ways, often to treat tissue surrounding a tumor area after surgical removal of the tumor and also as the primary treatment for tumors. Radiation therapy treatments impact both cancer cells as well as healthy tissue; therefore the total prescribed radiation dose is divided into many fractions and delivered in an average of 25 to 35 treatment sessions over several weeks. Radiation therapy has been widely available and used in developed countries for decades, though many developing countries do not currently have a sufficient number of radiation therapy systems to adequately treat their domestic cancer patient populations. The number of radiation therapy systems in use and sold each year is currently many times larger than the number of radiosurgery systems. Large companies, including Varian Medical Systems, Inc. and Elekta AB, generate most sales in this market. We believe the TomoTherapy Systems offer clinicians and patients significant benefits over other radiation therapy systems in the market. We believe our ability to capture more sales in this established market will be influenced by a number of factors including the following:

- Adoption of our recently launched new TomoTherapy platform and receipt of regulatory clearances associated with such new platform;
- Greater awareness among doctors and patients of the benefits of radiation therapy using TomoTherapy Systems;
- Advances in technology which improve the quality of treatments and ease of use of TomoTherapy Systems;
- Greater awareness among doctors of the improvement in reliability of TomoTherapy Systems; and
- Expansion of TomoTherapy System sales in countries throughout the world.

**Sale of Our Products**



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Generating revenue from the sale of our systems is a lengthy process. Selling our systems, from first contact with a potential customer to a signed sales contract that meets backlog criteria, generally spans six months to two years. The time from receipt of a signed contract to revenue recognition is governed generally by the time required by the customer to build, renovate or prepare the treatment room for installation of the system. This time varies significantly, generally from six to twenty-four months.

In the United States, we market to customers, including hospitals and stand-alone treatment facilities, directly through our sales organization. Outside the United States, we market to customers in over 80 countries directly and through distributors. We have sales and service offices in Japan and many countries in Europe and Asia.

The following table shows the number of systems installed by geographic region as of September 30, 2012:

|                                       |     |
|---------------------------------------|-----|
| Americas                              | 376 |
| Europe, Middle East, India and Africa | 150 |
| Asia (excluding Japan)                | 86  |
| Japan                                 | 55  |
| Total                                 | 667 |

International sales of our products account for a significant and growing portion of our total net revenue. Revenue derived from sales outside of the United States was \$46.9 million and \$51.6 million for the three months ended September 30, 2012 and 2011, respectively, and represented 57% and 51% of our net sales during these periods, respectively.

### ***Backlog***

We report backlog in the following manner:

- **Products:** Orders for systems, upgrades, and our shared ownership program are reported in backlog, excluding amounts attributable to PCS (warranty period services and post warranty services), installation, training and professional services.
- **Service:** Orders for PCS, installation services, training and professional services are not reported in backlog.

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For orders that cover both products and services, only the portion of the order that is recognized as product revenue is reported as backlog. The portion of the order that is recognized as service revenue (for example, PCS) is not included in reported backlog. Additionally, orders for TomoTherapy Systems made on or before June 30, 2011, that met the historical TomoTherapy backlog criteria have been grandfathered into, and are included in, our backlog, with the exception of orders that would have aged out as of June 30, 2011. TomoTherapy previously did not have an age out criteria, so we have adjusted the TomoTherapy backlog to age out orders where 2.5 years have passed from the time the order entered TomoTherapy's backlog. As of September 30, 2012, product only backlog was \$294.3 million as compared to \$270.8 million as of September 30, 2011.

In order for the product portion of a sales agreement to be counted as backlog, it must meet the following criteria:

- The contract is signed and properly executed by both the customer and us. A customer purchase order that is signed and incorporates the terms of our contract quote will be considered equivalent to a signed and executed contract;
- The contract is non-contingent it either has cleared all its contingencies or contains no contingencies when signed;
- We have received a minimum deposit or a letter of credit; the sale is a direct channel sale to a government entity, or the product has shipped to a customer with credit sufficient to cover the minimum deposit;
- The specific end customer site has been identified by the customer in the written contract or written amendment; and
- Less than 2.5 years have passed since the contract met all the criteria above.

Although our backlog includes only contractual agreements from our customers to purchase CyberKnife Systems or TomoTherapy Systems, we cannot provide assurance that we will convert backlog into recognized revenue due to factors outside our control, which includes, without limitation, changes in customers' needs or financial condition, changes in government or health insurance reimbursement policies, changes to regulatory requirements, or other reasons for cancellation of orders.

We also use book-to-bill ratios to assess the quality and growth of our backlog. The ratio is calculated for a period as new orders booked and included in backlog upon meeting criteria described above less any orders cancelled from backlog, and the resultant net orders being divided by total product revenue recognized during that period.

[Table of Contents](#)**Results of Operations***Three months ended September 30, 2012 compared to three months ended September 30, 2011***Net Revenue**

| (Dollars in thousands) | Three Months Ended<br>September 30, |        |      | Variance | Variance in<br>Percent |
|------------------------|-------------------------------------|--------|------|----------|------------------------|
|                        | 2012                                |        | 2011 |          |                        |
| Products               | \$                                  | 40,628 | \$   | 56,174   | \$ (15,546) -28%       |
| Services               |                                     | 42,120 |      | 43,401   | (1,281) -3%            |
| Other                  |                                     |        |      | 876      | (876) -100%            |
| Net Revenue            | \$                                  | 82,748 | \$   | 100,451  | \$ (17,703) -18%       |

Total product revenues during the three months ended September 30, 2012 decreased by 28% from the three months ended September 30, 2011 primarily due to a lower number of unit sales, which was partially offset by higher revenue per unit and decreases in revenue deferrals for units sold with extended payment terms. We recognized revenues on 15 units during the three months ended September 30, 2012 as compared to 24 units during the three months ended September 30, 2011.

Services revenues during the three months ended September 30, 2012 decreased by \$1.3 million from the three months ended September 30, 2011. Service revenues were higher in the three months ended September 30, 2011 due to inclusion of \$5.1 million of service revenues arising from purchase accounting adjustments related to the TomoTherapy acquisition which was completed in June 2011. Such purchase accounting adjustments were not material during the three months ended September 30, 2012. Excluding such adjustments, service revenues increased by \$3.8 million during the three months ended September 30, 2012 as compared to the three months ended September 30, 2011 due to increases in our installed base. We expect our service revenue to increase as our installed base continues to grow.

**Gross Profit**

|              | Three Months Ended September 30, |        |                       | 2011                      | (% of net<br>revenue) |
|--------------|----------------------------------|--------|-----------------------|---------------------------|-----------------------|
|              | 2012                             |        |                       |                           |                       |
|              | (Dollars in<br>thousands)        |        | (% of net<br>revenue) | (Dollars in<br>thousands) |                       |
| Gross profit | \$                               | 23,676 | 28.6%                 | \$                        | 24,428 24.3%          |
| Products     |                                  | 16,619 | 40.9%                 |                           | 17,801 31.7%          |
| Services     |                                  | 7,057  | 16.8%                 |                           | 6,052 13.9%           |
| Other        |                                  |        | 0.0%                  |                           | 575 65.6%             |

Gross margins during the three months ended September 30, 2012 improved by 4.3 percentage points as compared to the three months ended September 30, 2011. Product margins were higher during the three months ended September 30, 2012 primarily due to the favorable impact of a net reduction in purchase accounting adjustments resulting from the acquisition of TomoTherapy on June 10, 2011. Service margins were higher

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during the three months ended September 30, 2012 primarily due to improvements in the reliability of the TomoTherapy Systems, partially offset by the unfavorable impact of a net reduction in purchase accounting adjustments resulting from the acquisition of TomoTherapy on June 10, 2011.

In accordance with purchase accounting standards, a number of adjustments were recorded to the value of assets and liabilities of TomoTherapy as of the closing of the acquisition on June 10, 2011. These included the write-up of inventory based on selling price rather than cost of manufacturing, the write-down of deferred product revenue, the write-up of deferred service revenue, and the recording of intangible assets related to developed technology and to backlog existing at the time of the acquisition. On the acquisition date, deferred service and product revenues were valued at cost plus a reasonable margin. Purchase accounting adjustments reduced gross profit for the three months ended September 30, 2011 by \$9.2 million as follows: Product revenues were reduced by \$0.5 million while product cost of revenues was increased by \$11.4 million; Services revenues were increased by \$5.1 million while services cost of revenues was increased by \$2.4 million. Purchase accounting adjustments reduced gross profit for the three months ended September 30, 2012 by \$3.6 million resulting primarily from the reduction of product revenue by \$0.3 million and increases in product cost of revenues by \$3.4 million. The impact of purchase accounting adjustments, other than the amortization of intangible assets assigned to developed technology, are expected to be significantly smaller during the rest of fiscal 2013 and subsequent years.

Table of Contents**Selling and Marketing**

| (Dollars in thousands)    | Three Months Ended<br>September 30, |           |          | Variance | Variance in<br>Percent |
|---------------------------|-------------------------------------|-----------|----------|----------|------------------------|
|                           | 2012                                | 2011      |          |          |                        |
| Selling and marketing     | \$ 12,889                           | \$ 13,581 | \$ (692) |          | -5%                    |
| Percentage of net revenue | 15.6%                               | 13.5%     |          |          |                        |

Selling and marketing expenses decreased by \$0.7 million during the three months ended September 30, 2012 as compared to the three months ended September 30, 2011 primarily due to decreases in travel, tradeshow and other operational related expenses of \$1.0 million due to cost control initiatives, which was partially offset by increases in compensation and facilities related expenses of \$0.4 million due to increases in headcount.

**Research and Development**

| (Dollars in thousands)    | Three Months Ended<br>September 30, |           |          | Variance | Variance in<br>Percent |
|---------------------------|-------------------------------------|-----------|----------|----------|------------------------|
|                           | 2012                                | 2011      |          |          |                        |
| Research and development  | \$ 20,209                           | \$ 20,565 | \$ (356) |          | -2%                    |
| Percentage of net revenue | 24.4%                               | 20.5%     |          |          |                        |

Research and development expenses decreased by \$0.4 million during the three months ended September 30, 2012 as compared to the three months ended September 30, 2011 primarily due to decreases in project related consulting and travel costs of \$1.2 million due to cost control initiatives, which was partially offset by increases in compensation, employee related costs and facilities related expenses of \$0.7 million due to increases in headcount.

**General and Administrative**

| (Dollars in thousands)     | Three Months Ended<br>September 30, |           |            | Variance | Variance in<br>Percent |
|----------------------------|-------------------------------------|-----------|------------|----------|------------------------|
|                            | 2012                                | 2011      |            |          |                        |
| General and administrative | \$ 13,269                           | \$ 14,969 | \$ (1,700) |          | -11%                   |
| Percentage of net revenue  | 16.0%                               | 14.9%     |            |          |                        |

General and administrative expenses decreased by \$1.7 million during the three months ended September 30, 2012 as compared to the three months ended September 30, 2011 primarily due to lower consulting, legal and accounting related expenses of \$1.5 million.

**Impairment of indefinite lived intangible assets**

We incurred \$12.2 million of impairment charges related to the write-down of our in-process research and development (IPR&D) asset during the three months ended September 30, 2012 based on results of research and development work carried out by CPAC, a variable interest entity consolidated by us. See Note 3, Goodwill and Intangible Assets for details.

**Other Income (Expense), Net**

| (Dollars in thousands)      | Three Months Ended<br>September 30, |       |      |         | Variance<br>Percent |            |
|-----------------------------|-------------------------------------|-------|------|---------|---------------------|------------|
|                             | 2012                                |       | 2011 |         |                     |            |
| Other income (expense), net | \$                                  | (747) | \$   | (2,858) | \$                  | 2,111 -74% |

Other income (expense), net, was \$0.7 million of net other expense for the three months ended September 30, 2012, compared to net other expense of \$2.9 million for the three months ended September 30, 2011. During the three months ended September 30, 2012, we incurred interest expense of \$2.1 million related to our 3.75% Convertible Senior Notes due August 1, 2016 (the Convertible Notes). This was partially offset by gains of \$0.9 million from foreign currency transactions primarily due to the appreciation of the Japanese Yen against the U.S. Dollar and recognition of a \$0.7 million gain on our previously held equity interest in Morphormics, Inc., resulting from our acquisition of Morphormics on July 16, 2012. See Note 6, Acquisition for further details.

During the three months ended September 30, 2011, we incurred interest expense of \$1.3 million related to our Convertible Notes which were issued on August 1, 2011, and foreign currency transaction losses of \$1.5 million.

Table of Contents**Provision for Incomes Taxes**

| (Dollars in thousands)  | Three Months Ended<br>September 30, |              |      |              | Variance |    | Variance in<br>Percent |
|---|-------------------------------------|--------------|------|--------------|----------|----|------------------------|
|   | 2012                                |              | 2011 |              |          |    |                        |
| Provision for income taxes                                      | \$                                  | 597          | \$   | 538          | \$       | 59 | 11%                    |
| <i>Percentage of loss before provision for<br/>income taxes</i> |                                     | <i>-1.7%</i> |      | <i>-2.0%</i> |          |    |                        |

On a quarterly basis, we provide for income taxes based upon an estimated annual effective income tax rate. For the three months ended September 30, 2012 and 2011, we recorded income tax expense of \$0.6 million and \$0.5 million, respectively. The increase was primarily due to increased earnings in international locations.

**Investments in CPAC**

The condensed consolidated financial statements include the results of a variable interest entity, Compact Particle Acceleration Corporation ( CPAC ), since we are deemed to be the primary beneficiary of that entity. Also refer to Note 9, Investment in CPAC , for additional details. At September 30, 2012, our equity investment in CPAC was \$4.3 million and our outstanding receivables from CPAC were \$2.6 million, which includes \$1.9 million of the principal portion of a revolving promissory note issued by CPAC. Our equity investment and the outstanding receivables are eliminated in consolidation. If CPAC is not successful in raising additional funds to continue its development efforts, or if it is not successful in development of the compact proton accelerator technology, or if it is not successful in commercialization of the technology, or if we are not in a position to finance our option to purchase CPAC or to become a supplier or distributor of its technology, we may need to write down or write off our equity investments and outstanding receivables.

**Performance-based Awards**

During fiscal 2012, the Compensation Committee of our Board of Directors of the Company approved the granting of Performance-Based Stock Units ( PSUs ) to employees of the Company which vest only upon meeting certain financial performance criteria during the performance period commencing on the first day of our 2012 fiscal year and ending on the last day of our 2013 fiscal year. In the event that the PSUs do not become vested as a result of the Company's performance during the performance period, all PSUs are automatically forfeited by the participants effective as of the last day of the performance period. During fiscal 2012, approximately 1.0 million PSUs were granted to employees valued at approximately \$3.9 million which was based on the fair value of the Company's common stock on the grant date and will be recognized over the requisite performance period based on our assessment of the probability of achieving the performance criteria. Approximately 0.9 million PSUs are outstanding as of September 30, 2012.

As of September 30, 2012, we have assessed that it was not probable that the performance criteria would be met during the performance period and accordingly, no compensation cost has been recognized for the PSUs to date or during the three months ended September 30, 2012. If in a future period management revises its assessment and concludes that it is probable that the performance criteria will be met, we will record a cumulative catch up compensation charge for the PSUs in that period. Remaining compensation charges for the PSUs would be recognized ratably over the remaining performance period.

### **Market Stock Unit ( MSU ) program**

In October 2012, the Compensation Committee approved a new performance equity program, referred to as the market stock unit program ( MSU Program ). The program uses the Russell 2000 index as a performance benchmark and requires that the Company's total stockholder return exceed that of the Russell 2000. Based on a sliding scale of how much the Russell 2000 benchmark is exceeded, participating executives can earn up to a maximum of 150% of the target number of shares over two measurement periods, one at the end of fiscal 2014 and another at the end of fiscal 2015.

### **Liquidity and Capital Resources**

At September 30, 2012, we had \$121.9 million in cash and cash equivalents. We expect to use cash for the balance of fiscal 2013 driven primarily by operating losses and capital expenditures. We anticipate that we will begin to generate positive cash flow in the later part of fiscal 2013. Cash from operations could be affected by various risks and uncertainties, including, but not limited to the risks included in Part II, Item 1A of this Form 10-Q and in Part I, Item 1A titled "Risk Factors" of Form 10-K for the year ended June 30, 2012. Also refer to Note 8, "Debt" to the condensed consolidated financial statements for discussion of the Convertible Notes. Based on our current business plan and revenue prospects, we believe that we will have sufficient cash resources and anticipated cash flows to fund our operations for at least the next 12 months.

### **Cash Flows From Operating Activities**

Net cash used in operating activities was \$13.2 million for the three months ended September 30, 2012 which was attributable to a net loss of \$36.2 million, offset by \$22.6 million of non-cash charges and cash provided by working capital changes of \$0.5 million. Non-cash charges primarily included \$12.2 million of impairment charges related to in-process research and development assets, depreciation and



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amortization expenses of \$7.8 million, share-based compensation expenses of \$1.8 million and accretion of interest expense on the Convertible Notes of \$1.0 million. Cash provided by working capital was primarily attributed to decreases in accounts receivable of \$10.8 million due to higher collections and lower billings and increases in accounts payable of \$9.8 million due to timing of vendor payments. This was partially offset by increases in prepayment and other assets of \$3.7 million due to payment of insurance premiums and increases in long-term receivables and decreases in accrued liabilities of \$14.9 million due to payment of bonuses, reduction of vacation accruals, payments for inventory buy-back obligations and other liabilities.

Net cash used in operating activities was \$49.3 million for the three months ended September 30, 2011 which was attributable to a net loss of \$28.1 million and cash used for working capital purposes of \$33.9 million, offset by \$12.7 million of non-cash charges. Cash used for working capital purposes primarily included decreases in accrued liabilities of \$19.7 million, decreases in accounts payable of \$14.0 million and an increase in accounts receivable of \$16.7 million, partially offset by decreases in inventory of \$11.5 million and increases in deferred revenues of \$7.8 million. Non-cash charges primarily included \$8.3 million of depreciation and amortization expense, \$2.6 million of share-based compensation and provision for write-down of inventories of \$1.6 million.

**Cash Flows From Investing Activities**

Net cash used in investing activities was \$9.4 million for the three months ended September 30, 2012, which primarily consisted of the purchase of property and equipment of \$5.3 million and \$3.9 million related to the acquisition of Morphormics.

Net cash used in investing activities was \$2.4 million for the three months ended September 30, 2011, which consisted of \$1.4 million related to the acquisition of TomoTherapy and cash used for purchases of property and equipment of \$1.0 million.

**Cash Flows From Financing Activities**

Cash flows from financing activities during the three months ended September 30, 2012 were not material.

Net cash provided by financing activities was \$97.0 million for the three months ended September 30, 2011. In August 2011, we issued the Convertible Notes for net proceeds of \$96.1 million. In addition, we received \$0.9 million attributable to proceeds from the exercise of common stock options and the purchase of common stock under our employee stock plans.

**Operating Capital and Capital Expenditure Requirements**

Our future capital requirements depend on numerous factors. These factors include but are not limited to the following:

- Revenue generated by sales of our products, our shared ownership program and service plans;
- Costs associated with our sales and marketing initiatives and manufacturing activities;
- Facilities, equipment and IT systems required to support current and future operations;
- Rate of progress and cost of our research and development activities;
- Costs of obtaining and maintaining FDA and other regulatory clearances of our products;
- Effects of competing technological and market developments;
- Number and timing of acquisitions and other strategic transactions; and
- Costs associated with the integration of TomoTherapy.

If our cash and cash equivalents are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or debt securities or obtain additional credit facilities. The sale of additional equity or convertible debt securities could result in dilution to our stockholders. If additional funds are raised through the issuance of debt securities, these securities could have rights senior to those associated with our common stock and could contain covenants that would restrict our operations. Additional financing may not be available at all, or in amounts or on terms acceptable to us. If we are unable to obtain this additional financing, we may be required to reduce the scope of our planned product development and marketing efforts.

#### **Contractual Obligations and Commitments**

We presented our contractual obligations in our Annual Report on Form 10-K for the previous annual reporting period ended June 30, 2012. There have been no material changes outside of the ordinary course of business in those obligations during the current quarter.

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**Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements.

**Critical Accounting Policies and Estimates**

The discussion and analysis of our financial condition and results of operations is based on our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ). The preparation of these condensed consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, as well as revenue and expenses during the reporting periods. We evaluate our estimates and judgments on an ongoing basis. We base our estimates on historical experience and on various other factors we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities. Actual results could therefore differ materially from those estimates if actual conditions differ from our assumptions.

During the three months ended September 30, 2012, there have been no changes to the critical accounting policies and estimates as discussed in Part II, Item 7 of our Form 10-K for the year ended June 30, 2012, which we believe are those related to revenue recognition, business combinations and intangible asset impairment, inventories, share-based compensation expense, income taxes, loss contingencies and corporate bonus expense and accruals.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

***Foreign Currency Exchange Rate Risk***

Future fluctuations in the value of the U.S. dollar may affect the price competitiveness of our products outside the United States. For direct sales outside the United States, we sell in both U.S. dollars and local currencies, which could expose us to additional foreign currency risks, including changes in currency exchange rates. Our operating expenses in countries outside the United States, are payable in foreign currencies and therefore expose us to currency risk. To the extent that management can predict the timing of payments under sales contracts or for operating expenses that are denominated in foreign currencies, we may engage in hedging transactions to mitigate such risks in the future.

***Interest Rate Risk***

At September 30, 2012, we had \$29.9 million of cash equivalents invested in money market funds and certificates of deposit. Our earnings would not be materially affected by interest rate risk due to the low interest rate on these highly liquid investments.

***Equity Price Risk***

On August 1, 2011, we issued \$100 million aggregate principal amount of the Convertible Notes. Upon conversion, we can settle the obligation by issuing our common stock, cash or a combination thereof at an initial conversion rate equal to 105.5548 shares of common stock per \$1,000 principal amount of the Convertible Notes, which is equivalent to a conversion price of approximately \$9.47 per share of common stock, subject to adjustment. There is no equity price risk if the share price of our common stock is below \$9.47 upon conversion of the Convertible Notes. For every \$1 that the share price of our common stock exceeds \$9.47, we expect to issue an additional \$10.6 million in cash or shares of our common stock, or a combination thereof, if all of the Convertible Notes are converted.

**Item 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow for timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2012. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of September 30, 2012 our disclosure controls and procedures were effective to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

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*Changes in Internal Control Over Financial Reporting*

During the three months ended September 30, 2012, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

*Inherent Limitations of Internal Control Over Financial Reporting*

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and in reaching a reasonable level of assurance, management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings.**

Please refer to Note 5 to the condensed consolidated financial statements above for a description of certain legal proceedings currently pending against the Company. From time to time we are involved in legal proceedings arising in the ordinary course of our business.

**Item 1A. Risk Factors.**

A description of the risk factors associated with our business is included under Risk Factors contained in Part I, Item 1A. of our Form 10-K for the year ended June 30, 2012 and is incorporated herein by reference. The descriptions below include material changes to the risk factors affecting our business that were previously disclosed in such filing. Any risk factor included below supersedes the description of the relevant risk factor in such filing. Other than the items discussed below, there have been no material changes in our risk factors since such filing.

*If the CyberKnife or TomoTherapy Systems do not achieve widespread market acceptance, we will not be able to generate the revenue necessary to support our business.*

Achieving physician, patient, hospital administrator and third party payor acceptance of the CyberKnife and TomoTherapy Systems as preferred methods of tumor treatment will be crucial to our continued success. Physicians will not begin to use or increase the use of the CyberKnife or TomoTherapy Systems unless they determine, based on experience, clinical data and other factors, that the CyberKnife and TomoTherapy Systems are safe and effective alternatives to current treatment methods. We often need to educate physicians about the use of stereotactic radiosurgery, IGRT and adaptive radiation therapy, convince healthcare payors that the benefits of the CyberKnife and TomoTherapy Systems and their related treatment processes outweigh their costs and help train qualified physicians in the skilled use of the CyberKnife and TomoTherapy Systems. For example, the complexity and dynamic nature of stereotactic radiosurgery and Robotic IMRT as well as adaptive radiation therapy and IGRT, require significant education of hospital personnel and physicians regarding the benefits of stereotactic radiosurgery and Robotic IMRT, as well as adaptive radiation therapy and IGRT, and require departures from their customary practices. We have expended and will continue to expend significant resources on marketing and educational efforts to create awareness of stereotactic radiosurgery and Robotic IMRT as well as adaptive radiation therapy and IGRT generally and to encourage the acceptance and adoption of our products for these technologies.

The CyberKnife and TomoTherapy Systems are major capital purchases, and purchase decisions are greatly influenced by hospital administrators who are subject to increasing pressures to reduce costs. These and other factors, including the following, may affect the rate and level of market acceptance of each of the CyberKnife and TomoTherapy Systems:

- The CyberKnife and TomoTherapy Systems price relative to other products or competing treatments;
- Our ability to develop new products and enhancements and receive regulatory clearances and approval, if required, to existing products in a timely manner;
- Effectiveness of our sales and marketing efforts;
- The impact of the current economic environment on our business and our customer's business, including the postponement by our customers of purchase decisions or required build-outs;
- Capital equipment budgets of healthcare institutions;
- Increased scrutiny by state boards when evaluating certificates of need requested by purchasing institutions;

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- Perception by patients, physicians and other members of the healthcare community of the CyberKnife and TomoTherapy Systems safety, efficacy, efficiency and benefits compared to competing technologies or treatments;
- Publication in peer-reviewed medical journals of data regarding the successful use and longer term clinical benefits of the CyberKnife and TomoTherapy Systems;
- Willingness of physicians to adopt new techniques and the ability of physicians to acquire the skills necessary to operate the CyberKnife and TomoTherapy Systems;
- Extent of third party coverage and reimbursement rates, particularly from Medicare, for procedures using the CyberKnife and TomoTherapy Systems;
- Development of new products and technologies by our competitors or new treatment alternatives;
- Regulatory developments related to manufacturing, marketing and selling the CyberKnife and TomoTherapy Systems both within and outside the United States;
- Perceived liability risks arising from the use of new products; and
- Unfavorable publicity concerning the CyberKnife or TomoTherapy Systems or radiation based treatment alternatives.

In October 2012, we formally introduced two new versions of our technology platforms: the CyberKnife M6 Series and the TomoTherapy H Series. We expect that these new platforms will drive future orders and revenue growth. If either of these new CyberKnife or TomoTherapy Systems, or any of the CyberKnife or TomoTherapy Systems are unable to achieve or maintain market acceptance, new orders and sales of our systems would be adversely affected, our revenue levels would decrease and our business would be harmed.

***We have a large accumulated deficit, may incur future losses and may be unable to achieve profitability.***

As of September 30, 2012, we had an accumulated deficit of \$240.6 million. We may incur net losses in the future, particularly as we continue to increase our manufacturing, research and development and selling and marketing activities. Our ability to achieve and sustain long-term profitability is largely dependent on our ability to successfully market and sell the CyberKnife and TomoTherapy Systems and to control our costs and effectively manage our growth. We cannot assure you that we will be able to achieve profitability. In the event we fail to achieve profitability, our stock price could decline.

***If we are unable to develop new products or enhance existing products, we may be unable to attract or retain customers.***

Our success depends on the successful development, regulatory clearance or approval, introduction and commercialization of new generations of products, treatment systems, and enhancements to and/or simplification of existing products. The CyberKnife and TomoTherapy Systems, which are currently our principal products, are technologically complex and must keep pace with, among other things, the products of our competitors. We are making significant investments in long-term growth initiatives. Such initiatives require significant capital commitments, involvement of senior management and other investments on our part, which we may be unable to recover. Our timeline for the development of new products or

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enhancements may not be achieved and price and profitability targets may not prove feasible. Commercialization of new products may prove challenging, and we may be required to invest more time and money than expected to successfully introduce them. Once introduced, new products may adversely impact orders and sales of our existing products, or make them less desirable or even obsolete. Compliance with regulations, competitive alternatives, and shifting market preferences may also impact the successful implementation of new products or enhancements. This includes two new versions of our technology platforms: the CyberKnife M6 Series and the TomoTherapy H Series, which we formally introduced in October 2012.

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;
- Educate physicians about the use of new products and procedures;
- 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 obtaining regulatory approvals or clearances;
- 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 old and new products; and
- Anticipate and compete successfully with competitors.

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.



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We cannot be sure that we will be able to successfully develop, obtain regulatory approval or clearance for, manufacture or introduce new products, treatment systems or enhancements, the roll-out of which involves compliance with complex quality assurance processes, including the quality system regulation, or QSR, enforced by the FDA. Failure to obtain regulatory approval or clearance for our products or to complete these processes in a timely and efficient manner could result in delays that could affect our ability to attract and retain customers, or could cause customers to delay or cancel orders, causing our backlog, revenues and operating results to suffer.

***If third party payors do not provide sufficient coverage and reimbursement to healthcare providers for use of the CyberKnife and TomoTherapy Systems, demand for our products and our revenue could be adversely affected.***

Our customers rely significantly on reimbursement for CyberKnife and TomoTherapy procedures. Our ability to commercialize our products successfully will depend in significant part on the extent to which public and private third party payors provide adequate coverage and reimbursement for procedures that are performed with our products. Third-party payors, and in particular managed care organizations, challenge the prices charged for medical products and services and institute cost containment measures to control or significantly influence the purchase of medical products and services. If reimbursement policies or other cost containment measures are instituted in a manner that significantly reduces the coverage for or payment for the procedures that are performed with our products, our existing customers may not continue using our products or may decrease their use of our products, and we may have difficulty obtaining new customers. Such actions would likely have a material adverse effect on our operating results. In November 2012, the centers for Medicare and Medicaid Services, or CMS, issued the 2013 Medicare payment rates for hospital outpatient services, for physicians, and services performed in the freestanding center setting for calendar year 2013. While some of the reimbursement rates are modestly higher than in the prior year, others are modestly lower than in the prior year, which could have a negative impact on the continued use of our products by existing customers and our ability to obtain new customers. The final rates for 2013 increase payment in the hospital outpatient setting for many professional and technical codes billed in conjunction with both IMRT and robotic radiosurgery. The payment for robotic radiosurgery delivery decreased slightly while the payment for IMRT delivery increased slightly. CMS reviews such rates annually, and could implement more significant changes in future years.

In 2013, payment for robotic radiosurgery will continue to be set by local Medicare carriers in the freestanding center setting for robotic radiosurgery delivery. For delivery of IMRT in the freestanding clinic, Medicare has released its conversion factor, resource and malpractice values and geographic adjustment indices that would be used to calculate payment in 2013. In addition to making an adjustment to the conversion factor (the multiplier used to calculate rates for all services priced under the Physician Fee Schedule), CMS made targeted cuts to IMRT based on its belief that shorter treatment times are typically seen in practice, as opposed to the longer times which had previously been used to calculate IMRT payment. While the time-based proposal by CMS was retained in the final rule, CMS considered other direct and indirect inputs that mitigated the overall payment reduction to less than half what it proposed for the reimbursement rate for IMRT. The rate calculation, using both the proposed conversion factor and time-based reduction, would result in a 37% decrease in the payment rate from 2012 rates if Congress does not intervene to prevent major cuts in Medicare as it has done for the past nine years. Based on historical actions, we expect that the conversion factor will remain closer to the conversion factor used to calculate 2012 rates, however, if the time-based reductions remain in place, we expect the reduction to result in approximately a 15% decrease as compared to 2012 rates.

If in the future CMS significantly decreases reimbursement rates for stereotactic radiosurgery, Robotic IMRT or radiation therapy services, or if other cost containment measures are implemented in the United States or elsewhere, such changes could discourage cancer treatment centers and hospitals from purchasing our products. We have seen our customers' decision making process complicated by the uncertainty surrounding the proposed reduction in Medicare reimbursement rates for radiotherapy and radiosurgery at freestanding clinics in the United States and for physician reimbursement for radiation oncology, which has resulted in delay and sometimes even failure to purchase our products.

***Our industry is subject to intense competition and rapid technological change, which may result in products or new tumor treatments that are superior to the CyberKnife and TomoTherapy Systems. If we are unable to anticipate or keep pace with changes in the marketplace and***

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*the direction of technological innovation and customer demands, our products may become obsolete or less useful and our operating results will suffer.*

The medical device industry in general and the non-invasive cancer treatment field in particular are subject to intense and increasing competition and rapidly evolving technologies. 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. To compete successfully, we will need to continue to demonstrate the advantages of our products and technologies over well-established alternative procedures, products and technologies, and convince physicians and other healthcare decision makers of the advantages of our products and technologies. Traditional surgery and other forms of minimally invasive procedures, brachytherapy, chemotherapy or other drugs remain alternatives to the CyberKnife and TomoTherapy Systems.

We consider the competition for the TomoTherapy Systems to be existing radiation therapy systems, primarily using C-arm linacs, which are sold by large, well-capitalized companies with significantly greater market share and resources than we have. Several of these competitors are also able to leverage their fixed sales, service and other costs over multiple products or product lines. In particular, we compete with a number of existing radiation therapy equipment companies including Varian Medical Systems, Inc., Elekta AB, Mitsubishi Heavy Industries, and to a lesser extent, BrainLAB AG. Varian Medical Systems has been the leader in the external beam radiation therapy market for many years and has the majority market share for radiation therapy systems worldwide. In 2008, Varian began selling and installing RapidArc technology. The RapidArc technology purports to be able to deliver image guided, intensity modulated radiation therapy more rapidly than other similar systems, including the TomoTherapy Systems, and Varian has maintained a strong marketing campaign claiming this technology has the same capabilities as, or better capabilities than, our TomoTherapy Systems. In April, 2010, Varian announced the launch of a new line of TrueBeam systems, which Varian claims are specifically designed for high-precision image guided radiotherapy and radiosurgery. Varian claims this new platform is designed to be versatile and can be used for all forms of advanced external beam radiation therapy. In April 2012, Varian and Siemens announced that they had entered into a strategic global partnership involving mutual marketing and representation of products for imaging and treatment in the global radiation oncology business, the development of software interfaces between Siemens and Varian treatment systems and potential joint development of new products.

The CyberKnife System also competes directly with conventional linac based radiation therapy systems primarily from Elekta AB, BrainLAB AG, Mitsubishi Heavy Industries and Varian Medical Systems. At least one other company has announced that it is developing a product that, if introduced, would be directly competitive with the CyberKnife System. In general, because of aging demographics and attractive market factors in oncology, we believe that new competitors will enter the radiosurgery and radiation therapy markets in the years ahead. The CyberKnife System has not typically been used to perform traditional radiation therapy and therefore competition has been limited with conventional medical linacs that perform traditional radiation therapy. However, the CyberKnife VSI System, which we introduced in November of 2009, may be used to perform Robotic IMRT, an advanced method of traditional radiation therapy, which products of Elekta, Siemens and Varian are also capable of performing. The new CyberKnife M6 Series, which we introduced in October 2012, includes the option of a multi-leaf collimator (MLC) which may further the use of the CyberKnife system to perform radiation therapy. In October 2012, Varian announced a new line of C-arm gantries, called the Edge systems, which Varian claims are specifically designed for radiosurgery to compete with our CyberKnife Systems. In addition, some manufacturers of conventional linac based radiation therapy systems, including Varian and Elekta, have products that can be used in combination with body and/or head frames and image guidance systems to perform both radiosurgical and radiotherapy procedures.

Furthermore, many government, academic and business entities are investing substantial resources in research and development of cancer treatments, including surgical approaches, radiation treatment, MRI-guided radiotherapy systems, proton therapy systems, drug treatment, gene therapy (which is the treatment of disease by replacing, manipulating, or supplementing nonfunctional genes), and other approaches. Successful developments that result in new approaches for the treatment of cancer could reduce the attractiveness of our products or render them obsolete.

Our future success will depend in large part on our ability to establish and maintain a competitive position in current and future technologies. Rapid technological development may render the CyberKnife and TomoTherapy Systems and their technologies obsolete. Many of our competitors have or may have greater corporate, financial, operational, sales and marketing resources, and more experience and resources in research and development than we have. We cannot assure you that our competitors will not succeed in developing or marketing technologies or products that are more effective or commercially attractive than our products or that would render our technologies and products obsolete or



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less useful. We may not have the financial resources, technical expertise, marketing, distribution or support capabilities to compete successfully in the future. Our success will depend in large part on our ability to maintain a competitive position with our technologies.

Our competitive position also depends on:

- Widespread awareness, acceptance and adoption by the radiation oncology and cancer therapy markets of our products;
- The development of new technologies that improve the effectiveness and productivity of the CyberKnife System radiosurgery process and the TomoTherapy System radiation therapy process;
- Product and procedure coverage and reimbursement from third party payors, insurance companies and others;
- Availability of adequate coverage and reimbursement from third party payors, insurance companies and others for procedures performed using our systems;
- Properly identifying customer needs and delivering new products or product enhancements to address those needs;
- Published, peer-reviewed studies supporting the efficacy and safety and long-term clinical benefit of the CyberKnife and TomoTherapy Systems;
- Limiting the time required from proof of feasibility to routine production;
- Limiting the timing and cost of obtaining regulatory approvals or clearances;
- The manufacture and delivery of our products in sufficient volumes on time, and accurately predicting and controlling costs associated with manufacturing, installation, warranty and maintenance of the products;
- Our ability to attract and retain qualified personnel;
- The extent of our intellectual property protection or our ability to otherwise develop proprietary products and processes;
- The ability of our competitors to obtain government funding for the development of intellectual property in foreign jurisdictions;
- Securing sufficient capital resources to expand both our continued research and development, and sales and marketing efforts; and
- Obtaining and maintaining any necessary United States or foreign market approvals or clearances.

If customers choose not to purchase a CyberKnife or TomoTherapy System or choose to purchase our competitors' products, our revenue and market share would be adversely impacted, and there could be a material adverse effect on our business, financial condition and results of operations. In addition, companies in the pharmaceutical or biotechnology fields may seek to develop methods of cancer treatment that are more effective than radiation therapy and radiosurgery, resulting in decreased demand for the TomoTherapy or CyberKnife Systems. Because the CyberKnife and TomoTherapy Systems have a long development cycle and because it can take significant time to receive government approvals or clearances for changes to the CyberKnife and TomoTherapy Systems, we must anticipate changes in the marketplace and the direction of

technological innovation. Accordingly, if we are unable to anticipate and keep pace with new innovations in the cancer treatment market, the CyberKnife or TomoTherapy Systems or an aspect of their functionality may be rendered obsolete, which would have a material adverse effect on our business, financial condition and results of operations. In addition, some of our competitors may compete by changing their pricing model or by lowering the price of their conventional radiation therapy systems or ancillary supplies, or by combining with other competitors. If such pricing strategies are implemented, there could be downward pressure on the price of radiation therapy and radiosurgery systems. If we are unable to maintain or increase our selling prices, our gross margins will decline, and there could be a material adverse effect on our business, financial condition and results of operations.

***We depend on key employees, the loss of whom would adversely affect our business. If we fail to attract and retain employees with the expertise required for our business, we may be unable to continue to grow our business.***

We are highly dependent on the members of our senior management, operations and research and development staff. In October 2012, we hired a new CEO. We are unable to predict how the market and our customers may react to such a leadership change. Our future success will depend in part on our ability to retain these key employees and to identify, hire and retain additional personnel. Competition for qualified personnel in the medical device industry, particularly in northern California and in Madison, Wisconsin, is intense, and finding and retaining qualified personnel with experience in our industry is very difficult. We believe there are only a limited number of individuals with the requisite skills to serve in many of our key positions and we compete for key personnel with other medical equipment and software manufacturers and technology companies, as well as universities and research institutions. It is increasingly difficult, time consuming and expensive to hire and retain these persons, and we may be unable to replace key persons if they leave or fill new positions requiring key persons with appropriate experience. A significant portion of our compensation to our key employees is in the form of stock option grants. A prolonged depression in our stock price could make it difficult for us to retain our employees and recruit additional qualified personnel. We do not maintain, and do not currently intend to obtain, key employee life insurance on any of our personnel. If we fail to hire and retain personnel in key positions, we may be unable to continue to grow our business successfully.

***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 product.***

The medical device industry is characterized by a substantial amount of litigation over patent and other intellectual property rights. In particular, the field of radiation treatment of cancer is well established and crowded with the intellectual property of competitors and others. We also expect that other participants will enter the field. A number of companies in our market, as well as universities and research institutions, have issued patents and have filed patent applications which relate to the use of radiation therapy and stereotactic radiosurgery to treat cancerous and benign tumors.

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Determining whether a product infringes a patent involves complex legal and factual issues, and the outcome of patent litigation actions is often uncertain. We have not conducted an extensive search of patents issued to third parties, and no assurance can be given that third party patents containing claims covering our products, parts of our products, technology or methods do not exist, have not been filed, or could not be filed or issued. Because of the number of patents issued and patent applications filed in our technical areas or fields, our competitors or other third parties may assert that our products and the methods we employ in the use of our products are covered by United States or foreign patents held by them. For example, on August 6, 2010, Best Medical International, Inc., or Best Medical, filed a lawsuit against Accuray in the U.S. District court for the Western District of Pennsylvania, claiming Accuray has infringed U.S. Patent No. 5,596,619, a patent that Best Medical alleges protects a method and apparatus for conformal radiation therapy, and on December 16, 2010, Best Medical filed an amended complaint, claiming that the Company also infringes U.S. Patent Nos. 6,038,283 and 7,266,175, both of which Best Medical alleges cover methods and apparatus for conformal radiation therapy. On March 9, 2011, the Court dismissed with prejudice all counts against the Company, except for two counts of alleged willful infringement of two of the patents. The Court issued a Scheduling Order on May 12, 2011 appointing a special master for claim construction, and setting a claim construction hearing on January 10, 2012. Best Medical moved to voluntarily dismiss one of the two remaining patents on June 28, 2011, which the court granted on June 30, 2011, leaving only one patent at issue in the case. The Court held a claim construction hearing on May 16, 2012, and the Company believes the court will issue a claim construction order sometime in December 2012 or January 2013. Best Medical is seeking declaratory and injunctive relief as well as unspecified compensatory and treble damages and other relief.

In addition, because patent applications can take many years to issue and because publication schedules for pending applications vary by jurisdiction, there may be applications now pending of which we are unaware, and which may result in issued patents which our current or future products infringe. Also, because the claims of published patent applications can change between publication and patent grant, there may be published patent applications that may ultimately issue with claims that we infringe. There could also be existing patents that one or more of our products or parts may infringe and of which we are unaware. As the number of competitors in the market for less invasive cancer treatment alternatives grows, and as the number of patents issued in this area grows, the possibility of patent infringement claims against us increases. Regardless of the merit of infringement claims, they can be time-consuming, result in costly litigation and diversion of technical and management personnel. Some of our competitors may be able to sustain the costs of complex patent litigation more effectively than we can because they have substantially greater resources. In addition, any uncertainties resulting from the initiation and continuation of any litigation could have a material adverse effect on our ability to raise funds, if necessary, to continue our operations.

In the event that we become subject to a patent infringement or other intellectual property lawsuit and if the relevant patents or other intellectual property were upheld as valid and enforceable and we were found to infringe or violate the terms of a license to which we are a party, we could be prevented from selling our products unless we could obtain a license or were able to redesign the product to avoid infringement. Required licenses may not be made available to us on acceptable terms or at all. If we were unable to obtain a license or successfully redesign our system, we might be prevented from selling our system. If there is an allegation or determination that we have infringed the intellectual property rights of a competitor or other person, we may be required to pay damages, or a settlement or ongoing royalties. In these circumstances, we may be unable to sell our products at competitive prices or at all, and thus, our business and operating results could be harmed.

***Our operations are vulnerable to interruption or loss due to natural disasters, epidemics, terrorist acts and other events beyond our control, which would adversely affect our business.***

We have facilities in countries around the world, including three manufacturing facilities, each of which is equipped to manufacture unique components of our products. The manufacturing facilities are located in Sunnyvale, California, Madison, Wisconsin and Chengdu, China. We do not maintain backup manufacturing facilities for all of our manufacturing facilities or for our IT facilities, so we depend on each of our current facilities for the continued operation of our business. In addition, we conduct a significant portion of other activities, including administration and data processing, at facilities located in the State of California which has experienced major earthquakes in the past, as well as other natural disasters. Chengdu, China, where one of our manufacturing facilities is located, has also experienced major earthquakes in the past. We do not carry earthquake insurance. Unexpected events at any of our facilities, including fires or explosions; natural disasters, such as hurricanes, floods, tornados and earthquakes; war or terrorist activities; unplanned outages; supply disruptions; and failures of equipment or systems, or the failure

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to take adequate steps to mitigate the likelihood or potential impact of such events, could significantly disrupt our operations, delay or prevent product manufacture and shipment for the time required to repair, rebuild or replace our manufacturing facilities, which could be lengthy, result in large expenses to repair or replace the facilities, and adversely affect our results of operation.

The March 2011 earthquake and tsunami in Japan, and other collateral events, including, among others, the catastrophic loss of lives, businesses, infrastructure, and delays in transportation, may have a direct negative impact on us or an indirect impact on us by affecting our employees, customers, or the overall economy in Japan, and as a result, we may experience a reduction in demand for our products and services. In addition, we have experienced, and may continue to experience, delays in sales to potential customers in Japan. We may also experience delays in installation schedules for, or cancellations of sales to, existing Japanese customers. If installation schedules are delayed or products are not accepted by our customers in a timely manner, our reported revenues may differ materially from expectations. As a result of these events, our revenue and our results of operations could be adversely affected.

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In addition, the October 2012 hurricane on the east coast of the United States, and other collateral events, including, among others, the damage to businesses, infrastructure, and delays in transportation, may have a direct negative impact on us or an indirect impact on us by affecting our employees, customers, or the overall economy in United States, and as a result, we may experience a reduction in demand for our products and services. We may experience delays in sales to potential customers and delays in installation schedules for, or cancellations of sales to, existing customers that may have been affected by the hurricane. If installation schedules are delayed or products are not accepted by our customers in a timely manner, our reported revenues may differ materially from expectations. As a result of these events, our revenue and our results of operations could be adversely affected.

***If Compact Particle Acceleration Corporation ( CPAC ) is not able to achieve its goals, we may need to write down or write off our investment and outstanding receivables in CPAC.***

Since April 2008, TomoTherapy has been an investor in CPAC to continue development of its research initiative for a compact proton therapy system for the treatment of cancer. CPAC has sought, and is continuing to seek, investments from third parties to support the development of this technology. On April 20, 2012, we entered into various transactions with CPAC and its other stockholders pursuant to which we invested \$1.1 million and also converted the outstanding principal and accrued interest on our convertible promissory notes from CPAC for \$1.3 million. The other stockholders in CPAC also invested \$0.5 million and also converted their outstanding principal and accrued interest on the convertible promissory notes from CPAC for \$3.6 million. In connection with the transactions, we terminated our option to purchase a portion of the CPAC stock held by other CPAC investors. We now have the option, upon the occurrence of certain events, to elect to either acquire CPAC or enter into a non-exclusive supply and distribution agreement for CPAC's compact proton therapy products. The triggers for the option becoming exercisable include CPAC achieving certain technical milestones or the CPAC board approving a proposal for the acquisition of CPAC. If Accuray were to elect the option to acquire CPAC, the acquisition price would be equal to the fair market value of CPAC at such time, as determined by one or more appraisers. At September 30, 2012, our equity investment in CPAC was \$4.3 million and our outstanding receivables from CPAC were \$2.6 million.

In the future, CPAC will require additional funding to continue its development efforts. We cannot be certain that CPAC will be able to obtain all of the additional financing required for this project on commercially reasonable terms or that the technology development will be successful. Even if CPAC is able to obtain financing and the technology development is successful, CPAC may not have the resources to commercialize the compact proton system, the market requirements may change such that commercialization is no longer feasible, or we may not be in a position to finance our option to purchase CPAC or to become a supplier or distributor of its technology. If any or all of these risks occur, we may need to write down or write off our investment and outstanding receivables in CPAC, which could adversely affect our business, financial condition and results of operations.

***Our liquidity could be adversely impacted by adverse conditions in the financial markets.***

At September 30, 2012, we had \$121.9 million in cash and cash equivalents. The available cash and cash equivalents are held in accounts managed by third party financial institutions and consist of invested cash and cash in our operating accounts. The invested cash is invested in interest bearing funds managed by third party financial institutions, consisting of money market funds and certificates of deposit. To date, we have experienced no loss or lack of access to our invested cash or cash equivalents; however, we can provide no assurances that access to our invested cash and cash equivalents will not be impacted by adverse conditions in the financial markets.

At any point in time, we also have funds in our operating accounts that are with third party financial institutions that exceed the Federal Deposit Insurance Corporation, or FDIC, insurance limits. While we monitor daily the cash balances in our operating accounts and adjust the cash



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balances as appropriate, these cash balances could be impacted if the underlying financial institutions fail or become subject to other adverse conditions in the financial markets. To date, we have experienced no loss or lack of access to cash in our operating accounts.

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

#### *(a) Sales of Unregistered Securities*

None.

#### *(b) Use of Proceeds from Public Offering of Common Stock*

None.

#### *(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers*

None.

### **Item 3.** **Defaults Upon Senior Securities**

None.

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**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

| <b>Exhibit Number</b> | <b>Description</b>   |
|-----------------------|--|
| 31.1                  | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.  |
| 31.2                  | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.  |
| 32.1                  | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. 1350 |
| 101.INS*              | XBRL Instance Document   |
| 101.SCH*              | XBRL Taxonomy Extension Schema Document  |
| 101.CAL*              | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF*              | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB*              | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE*              | XBRL Taxonomy Extension Presentation Linkbase Document   |

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\* XBRL (eXtensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ACCURAY INCORPORATED

By: /s/ Joshua H. Levine  
Joshua H. Levine  
President and Chief Executive Officer

By: /s/ Derek Bertocci  
Derek Bertocci  
Senior Vice President and Chief Financial Officer

Date: November 8, 2012