VARIAN MEDICAL SYSTEMS INC
Form 10-Q
February 09, 2011
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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 December 31, 2010

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

Commission File Number 1-7598

VARIAN MEDICAL SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

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

(650) 493-4000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 120,047,856 shares of common stock, par value $1 per share, outstanding as of January 28, 2011.

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VARIAN MEDICAL SYSTEMS, INC.

FORM 10-Q for the Quarter Ended December 31, 2010

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

	Three Months Ended	
(In thousands, except per share amounts)	**December 31, 2010**	**January 1, 2010**
Revenues:		
Product	$ 431,794	$ 410,197
Service contracts and other	148,058	130,709
Total revenues	579,852	540,906
Cost of revenues:		
Product	247,440	237,369
Service contracts and other	65,573	62,520
Total cost of revenues	313,013	299,889
Gross margin	266,839	241,017
Operating expenses:		
Research and development	38,502	38,388
Selling, general and administrative	91,310	83,542
Total operating expenses	129,812	121,930
Operating earnings	137,027	119,087
Interest income	629	808
Interest expense	(555)	(1,104)
Earnings from operations before taxes	137,101	118,791
Taxes on earnings	40,612	40,016
Net earnings	$ 96,489	$ 78,775
Net earnings per share - Basic	$ 0.82	$ 0.64
Net earnings per share - Diluted	$ 0.80	$ 0.63

Shares used in the calculation of net earnings per share:

Weighted average shares outstanding - Basic	118,170	123,690
Weighted average shares outstanding - Diluted	121,212	125,061

See accompanying notes to the condensed consolidated financial statements.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except par values)	December 31, 2010	October 1, 2010 [1]
Assets		
Current assets:		
Cash and cash equivalents	$ 703,519	$ 520,221
Accounts receivable, net of allowance for doubtful accounts of $4,028 at December 31, 2010 and $4,209 at October 1, 2010	496,271	591,677
Inventories	402,768	363,933
Prepaid expenses and other current assets	106,371	87,267
Deferred tax assets	118,319	118,246
Total current assets	1,827,248	1,681,344
Property, plant and equipment, net	277,550	267,927
Goodwill	206,946	208,451
Other assets	159,225	166,230
Total assets	$ 2,470,969	$ 2,323,952
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 120,687	$ 119,018
Accrued expenses	266,293	287,851
Product warranty	52,980	53,233
Deferred revenues	127,339	141,916
Advance payments from customers	288,694	275,998
Short-term borrowings		20,000
Current maturities of long-term debt	7,233	5,525
Total current liabilities	863,226	903,541
Long-term debt	16,094	17,869
Other long-term liabilities	123,327	127,175
Total liabilities	1,002,647	1,048,585
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred stock of $1 par value: 1,000 shares authorized; none issued and outstanding		
Common stock of $1 par value: 189,000 shares authorized; 119,894 and 118,007 shares issued and outstanding at December 31, 2010 and at October 1, 2010, respectively	119,894	118,007
Capital in excess of par value	606,865	508,366
Retained earnings	783,087	686,598
Accumulated other comprehensive loss	(41,524)	(37,604)
Total stockholders equity	1,468,322	1,275,367

Total liabilities and stockholders' equity	$ 2,470,969	$ 2,323,952

(1) The condensed consolidated balance sheet as of October 1, 2010 was derived from audited financial statements as of that date, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

See accompanying notes to the consolidated financial statements.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended	
(In thousands)	December 31, 2010	January 1, 2010
Cash flows from operating activities:		
Net earnings	$ 96,489	$ 78,775
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Share-based compensation expense	12,564	8,845
Tax benefits from exercises of share-based payment awards	10,417	2,257
Excess tax benefits from share-based compensation	(9,236)	(1,430)
Depreciation	11,579	11,008
Amortization of intangible assets	786	927
Deferred taxes	2,603	(2,439)
Provision for doubtful accounts receivable	94	557
Net change in fair value of derivatives and underlying commitments	328	(432)
Income on equity investment in affiliate	(2,224)	(448)
Loss on sale or disposal of assets	12	2,043
Other	(13)	(304)
Changes in assets and liabilities:		
Accounts receivable	92,403	68,670
Inventories	(36,374)	(39,700)
Prepaid expenses and other current assets	(12,714)	(14,547)
Accounts payable	1,750	(12,295)
Accrued expenses	(24,847)	(21,892)
Deferred revenues	(14,577)	24,207
Product warranty	(533)	145
Advance payments from customers	12,712	26,890
Other long-term liabilities	(3,062)	(170)
Net cash provided by operating activities	138,157	130,667
Cash flows from investing activities:		
Purchases of property, plant and equipment	(22,611)	(7,554)
(Increase) decrease in cash surrender value of life insurance	198	(1,170)
Note repayment (receivable) from affiliate and other, net	145	(1,837)
Other, net	(313)	(5,119)
Net cash used in investing activities	(22,581)	(15,680)
Cash flows from financing activities:		
Repurchases of common stock		(55,172)
Proceeds from issuance of common stock to employees	76,806	8,782
Excess tax benefits from share-based compensation	9,236	1,430
Employees' taxes withheld and paid for restricted stock and restricted stock units	(79)	(347)
Repayments of bank borrowings	(67)	(62)
Net payments under line of credit agreements	(20,000)	
Other		(60)

Net cash (used in) provided by financing activities	65,896	(45,429)
Effects of exchange rate changes on cash and cash equivalents	1,826	2,408
Net increase in cash and cash equivalents	183,298	71,966
Cash and cash equivalents at beginning of period	520,221	553,529
Cash and cash equivalents at end of period	$ 703,519	$ 625,495

See accompanying notes to the condensed consolidated financial statements.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

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

Basis of Presentation

The condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements and the accompanying notes are unaudited and should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company s Annual Report on Form 10-K for the year ended October 1, 2010 (the 2010 Annual Report). In the opinion of management, the condensed consolidated financial statements herein include adjustments (consisting only of normal recurring adjustments) necessary for a fair statement of the Company s financial position as of December 31, 2010 and October 1, 2010, results of operations for the three months ended December 31, 2010 and January 1, 2010, and cash flows for the three months ended December 31, 2010 and January 1, 2010. The results of operations for the three months ended December 31, 2010 are not necessarily indicative of the operating results to be expected for the full fiscal year or any future period.

As discussed in Note 17 Discontinued Operations, the Company has classified the assets and liabilities of the scientific research instruments business (Research Instruments) of ACCEL Instruments GmbH (ACCEL, which has since changed its name to Varian Medical Systems Particle Therapy GmbH) as discontinued operations and presented its operating results as a discontinued operation in the Condensed Consolidated Statements of Earnings for all periods presented. Because amounts related to Research Instruments in the Condensed Consolidated Balance Sheets and the Condensed Consolidated Statements of Cash Flows were not material for any period presented, the Company has not segregated them from continuing operations. Unless noted otherwise, discussion in these notes pertains to the Company s continuing operations.

Fiscal Year

The fiscal years of the Company as reported are the 52- or 53- week periods ending on the Friday nearest September 30. Fiscal year 2011 is the 52-week period ending September 30, 2011, and fiscal year 2010 was the 52-week period that ended on October 1, 2010. The fiscal quarters ended December 31, 2010 and January 1, 2010 were both 13-week periods.

Principles of Consolidation

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

Use of Estimates

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

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

Fair Value of Financial Instruments

The carrying amounts of the Company s financial instruments, including cash and cash equivalents, accounts receivable, net of allowance for doubtful accounts, accounts payable and short-term borrowings, approximate fair value due to their short maturities. The fair value of the Company s long-term debt was estimated to be $25.1 million at December 31, 2010 and $25.4 million at October 1, 2010. The estimated fair value of long-term debt was based on the then-current rates available to the Company for debt of similar terms and remaining maturities. The Company determined the estimated fair value amount by using available market information and commonly accepted valuation methodologies. However, considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, the fair value estimate presented herein is not necessarily indicative of the amount that the Company or holders of the instruments could realize in a current market exchange. The use of different assumptions and/or estimation methodologies may have a material effect on the estimated fair value.

Allowance for Doubtful Accounts

The Company evaluates the creditworthiness of its customers prior to authorizing shipment for all major sale transactions. Except for government tenders, group purchases and orders with letters of credit in Oncology Systems, Security and Inspections Products (SIP) and Varian Particle Therapy, and orders in its X-ray Products business, the Company s payment terms usually require payment of a small portion of the total amount due when the customer signs the purchase order, a significant amount upon transfer of risk of loss to the customer and the remaining amount upon completion of the installation. The Company offers extended payment terms, sometimes beyond one year, to qualified customers in some circumstances. On a quarterly basis, the Company evaluates the accounts receivable aging report and provides an allowance in an amount the Company deems adequate for doubtful accounts. In evaluating the adequacy of the allowance for doubtful accounts, the Company considers factors such as age of the accounts receivable balances, historical experience, creditworthiness, the type of customer, and economic conditions that may affect a customer s ability to make payment. Account receivable balances deemed to be uncollectible or otherwise settled with a customer are charged to the allowance for doubtful accounts after all means of collection have been exhausted and the potential for recovery is considered remote.

Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued the consolidation guidance for variable-interest entities to replace the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable-interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable-interest entity that most significantly impact the entity s economic performance. The new guidance was effective for the Company in the first quarter of fiscal year 2011. The adoption of the new guidance did not have a material impact on its existing consolidated financial position, results of operations or cash flows.

In March 2010, the FASB issued the guidance related to the Milestone Method of Revenue Recognition (ASU 2010-17), which recognizes the milestone method as an acceptable revenue recognition method for substantive milestones in a research or development transaction. ASU 2010-17 was effective for the Company in the first quarter of fiscal year 2011. The adoption of the new guidance did not have a material impact on its consolidated financial position, results of operations or cash flows.

In July 2010, the FASB issued ASU 2010-20 to provide guidance to enhance disclosures related to the credit quality of a company s financing receivables portfolio and the associated allowance for credit losses. Pursuant to this guidance, a company is required to provide a greater level of disaggregated information about its allowance for credit loss with the objective of facilitating users evaluation of the nature of credit risk inherent in the company s portfolio of financing receivables, how that risk is analyzed and assessed in arriving at the allowance for credit losses, and the changes and reasons for those changes in the allowance for credit losses. The adoption of this new guidance related to the revised disclosures as of the end of the reporting period in the first quarter of fiscal year 2011 did not have any material impact on its consolidated financial position, results of operations or cash flows. The revised disclosures related to activities during the reporting period will be effective for the Company beginning in the second quarter of fiscal year 2011 and it is not expected to have a material impact on its consolidated financial position, results of operations and cash flows.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

2. BALANCE SHEET COMPONENTS:

The components of inventories were as follows:

(In millions)	December 31, 2010	October 1, 2010
Inventories:		
Raw materials and parts	$ 211.4	$ 208.8
Work-in-progress	72.2	54.3
Finished goods	119.2	100.8
Total inventories	$ 402.8	$ 363.9

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

(In millions)	December 31, 2010	October 1, 2010
Long-term income taxes payable	$ 55.1	$ 56.8
Other	68.2	70.4
Total other long-term liabilities	$ 123.3	$ 127.2

3. FAIR VALUE

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

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

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

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

The Company s financial assets and liabilities are valued using Level 1 and Level 2 inputs. Level 1 instrument valuations are obtained from quotes for transactions in active exchange markets involving identical assets. Level 2 instrument valuations include valuations obtained from quoted prices for identical assets in markets that are not active. In addition, the Company has elected to use the income approach to value its derivative instruments using standard valuation techniques and Level 2 inputs, such as currency spot rates, forward points and credit default swap spreads. The Company s derivative instruments are short-term in nature, typically one month to twelve months in duration. As of December 31, 2010, the Company did not have any financial assets or liabilities without observable market values that would require a high

level of judgment to determine fair value (Level 3 instruments). In addition, there were no significant transfers of assets or liabilities between Level 1 and Level 2 fair value measurements during the three months ended December 31, 2010 and January 1, 2010.

In the tables below, the Company has segregated all assets and liabilities that are measured at fair value on a recurring basis into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the measurement date.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

Assets/Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the Company s assets and liabilities that were measured at fair value on a recurring basis.

	Fair Value Measurement Using			
Type of Instruments (In millions)	**Quoted Prices in Active Markets for Identical Instruments (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Balance**
Assets at December 31, 2010:				
Money market funds	$ 129.0	$	$	$ 129.0
Total assets measured at fair value	$ 129.0	$	$	$ 129.0
Liabilities at December 31, 2010:				
Derivative liabilities	$	$ (0.7)	$	$ (0.7)
Total liabilities measured at fair value	$	$ (0.7)	$	$ (0.7)
Assets at October 1, 2010:				
Money market funds	$ 36.4	$	$	$ 36.4
Total assets measured at fair value	$ 36.4	$	$	$ 36.4
Liabilities at October 1, 2010:				
Derivative liabilities	$	$ (0.5)	$	$ (0.5)
Total liabilities measured at fair value	$	$ (0.5)	$	$ (0.5)

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

	Fair Value Measurement Using			
Line Item in Consolidated Balance Sheet (In millions)	**Quoted Prices in Active Markets for Identical Instruments (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Balance**
Assets at December 31, 2010:				
Cash and cash equivalents	$ 127.9	$	$	$ 127.9
Other assets	1.1			1.1
Total assets measured at fair value	$ 129.0	$	$	$ 129.0
Liabilities at December 31, 2010:				
Accrued liabilities	$	$ (0.7)	$	$ (0.7)
Total liabilities measured at fair value	$	$ (0.7)	$	$ (0.7)
Assets at October 1, 2010:				
Cash and cash equivalents	$ 35.3	$	$	$ 35.3
Other assets	1.1			1.1
Total assets measured at fair value	$ 36.4	$	$	$ 36.4
Liabilities at October 1, 2010:				
Accrued liabilities	$	$ (0.5)	$	$ (0.5)
Total liabilities measured at fair value	$	$ (0.5)	$	$ (0.5)

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

4. FINANCING RECEIVABLES AND ALLOWANCE FOR CREDIT LOSSES

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 note receivable and accounts receivable with contractual maturities of more than one year, and the related allowance for doubtful account are presented in the following table:

(In millions)	December 31, 2010
Accounts receivable with contractual maturities of more than one year:	
Gross amount	$ 9.4
Allowance for doubtful accounts	
Net amount	$ 9.4
Amount past due	$
Note receivable:	
Note receivable from related party	8.8
Note receivable from customer	1.0
Total note receivable	$ 9.8
Amount past due	$

5. GOODWILL AND INTANGIBLE ASSETS

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

(In millions)	December 31, 2010	October 1, 2010
Intangible Assets:		
Acquired existing technology	$ 20.5	$ 20.7
Patents, licenses and other	18.8	18.9
Customer contracts and supplier relationship	10.4	10.4
Accumulated amortization	(41.5)	(40.8)
Net carrying amount	$ 8.2	$ 9.2

Amortization expense for intangible assets was $0.8 million and $0.9 million for the three months ended December 31, 2010 and January 1, 2010, respectively. The Company estimates amortization expense on a straight-line basis for the remaining nine months of fiscal year 2011, fiscal years 2012 through 2015 and thereafter, to be as follows (in millions): $1.8, $1.7, $1.4, $0.6 and $2.7, respectively.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

The following table reflects the activity of goodwill by reportable operating segment:

(In millions)	Oncology Systems	X-ray Products	Other	Total
Balance at October 1, 2010	$ 126.7	$ 4.5	$ 77.3	$ 208.5
Payment or accrual of contingent consideration		0.6		0.6
Foreign currency translation adjustments			(2.2)	(2.2)
Balance at December 31, 2010	$ 126.7	$ 5.1	$ 75.1	$ 206.9

6. RELATED PARTY TRANSACTIONS

VMS has a 40% ownership interest in dpiX Holding LLC (dpiX Holding), a two-member consortium which has a 100% ownership interest in dpiX LLC (dpiX), a supplier of amorphous silicon based thin-film transistor arrays (flat panels) for the Company s X-ray Products digital image detectors and for its Oncology Systems On-Board Imager®, and PortalVision™ imaging products. In accordance with the dpiX Holding agreement, net losses were to be allocated to the members, in succession, until their capital accounts equaled zero, then to the members in accordance with their ownership interests. The dpiX Holding agreement also provided that net profits were to be allocated to the members, in succession, until their capital accounts equaled the net losses previously allocated, then to the members in accordance with their ownership interests.

The investment in dpiX Holding is accounted for under the equity method of accounting. When VMS recognizes its share of net profits or losses of dpiX Holding, profits in inventory purchased from dpiX are eliminated until realized by VMS. VMS recorded an income on the equity investment in dpiX Holding of $2.2 million in the three months ended December 31, 2010 and an income of $0.5 million in the three months ended January 1, 2010. Incomes and losses on the equity investment in dpiX Holding are included in Selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings. The carrying value of the investment in dpiX Holding, which was included in Other assets in the Condensed Consolidated Balance Sheets, was $45.2 million at December 31, 2010 and $45.1 million at October 1, 2010.

In February 2009, VMS agreed to loan $14 million to dpiX in four separate installments. The loan bears interest at prime plus 1% per annum. The principal balance is due and payable to VMS in four installments beginning in December 2011; interest is payable in full according to a quarterly schedule which began in April 2009; and the entire principal balance, together with accrued and unpaid interest thereon and all other related amounts payable thereunder, is due and payable on September 10, 2012. As of October 1, 2010 and December 31, 2010, VMS had loaned $8.8 million to dpiX under this loan agreement, with the current portion included in Prepaid expenses and other current assets and the long-term portion included in Other assets in the Condensed Consolidated Balance Sheet. The Company evaluates the collectability of its note receivable with dpiX at least on a quarterly basis, considering the timeliness of recurring payments as well as its financial position and cash flows, and recognizes an impairment loss for the amount the Company deemed uncollectible.

During the three months ended December 31, 2010 and January 1, 2010, the Company purchased glass transistor arrays from dpiX totaling approximately $6.6 million and $13.1 million, respectively. These purchases of glass transistor arrays are included as a component of Inventory in the Condensed Consolidated Balance Sheets and Cost of revenues - product in the Condensed Consolidated Statements of Earnings for these periods.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

7. PRODUCT WARRANTY

The following table reflects the changes in the Company s accrued product warranty:

	Three Months Ended	
(In millions)	December 31, 2010	January 1, 2010
Accrued product warranty, at beginning of period	$ 53.2	$ 50.8
Charged to cost of revenues	9.9	12.5
Actual product warranty expenditures	(10.1)	(12.6)
Accrued product warranty, at end of period	$ 53.0	$ 50.7

8. CREDIT FACILITY

In July 2007, VMS entered into a credit agreement with Bank of America, N.A. (BofA), which was amended and restated on November 10, 2008, and then again amended July 14, 2009, August 11, 2010 and August 24, 2010. As amended to date, the credit agreement with BofA provides for a revolving credit facility that enables the Company to borrow and have outstanding at any given time a maximum of $225 million (the Amended BofA Credit Facility). A portion of the Amended BofA Credit Facility is collateralized with a pledge of stock of certain of VMS s present and future subsidiaries that are deemed to be material subsidiaries. As of December 31, 2010, VMS has pledged to BofA 65% of the voting shares that it holds in Varian Medical Systems Nederland B.V., a wholly-owned subsidiary.

Under the Amended BofA Credit Facility, VMS s Japanese subsidiary (VMS KK) can borrow up to 2.7 billion Japanese Yen as part of the overall credit facility (the Japanese Line of Credit). At any time amounts are outstanding under the Japanese Line of Credit, the full borrowing capacity is deemed committed for use in Japan and therefore the maximum amount VMS can otherwise borrow under the Amended BofA Credit Facility will be reduced by $35 million to $190 million. VMS guarantees the payment of the outstanding balance under the Japanese Line of Credit.

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

As of December 31, 2010, there was no outstanding balance under the Amended BofA Credit Facility. At October 1, 2010, $20 million was outstanding under the Amended BofA Credit Facility with a weighted average interest rate of 1.51%, none of which was outstanding under the Japanese Line of Credit. Up to $25 million of the Amended BofA Credit Facility could also be used to support letters of credit issued on behalf

of the Company, of which none were outstanding as of December 31, 2010 or October 1, 2010.

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

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

9. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

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

	Asset Derivatives			Liability Derivatives		
(In millions)	Balance Sheet Location	December 31, 2010 Fair Value	October 1, 2010 Fair Value	Balance Sheet Location	December 31, 2010 Fair Value	October 1, 2010 Fair Value
Derivative designated as hedging instruments:						
Foreign exchange forward contracts	Prepaid Expenses	$	$	Accrued liabilities	$ 0.3	$ 0.5
Derivative not designated as hedging instruments:						
Foreign exchange forward contracts	Prepaid Expenses			Accrued liabilities	0.4	
Total derivatives		$	$		$ 0.7	$ 0.5

See Note 3, Fair Value and Valuation of Derivative Instruments under Critical Accounting Estimates in Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations regarding valuation of the Company s derivative instruments. Also see Note 1, Significant Accounting Policies to the Consolidated Financial Statements of the Company s 2010 Annual Report regarding credit risk associated with the Company s derivative instruments.

Cash Flow Hedging Activities

The Company has many transactions denominated in foreign currencies and addresses certain of those financial exposures through a risk management program that includes the use of derivative financial instruments. The Company sells products throughout the world, often in the currency of the customer s country, and may hedge certain of the larger foreign currency transactions when they are not denominated in the relevant subsidiary s functional currency. These foreign currency sales transactions are hedged using foreign currency forward contracts. The Company may use other derivative instruments in the future. The Company enters into foreign currency forward contracts primarily to reduce the effects of fluctuating foreign currency exchange rates. The Company does not enter into foreign currency forward contracts for speculative or trading purposes. The foreign currency forward contracts range from one to twelve months in maturity. As of December 31, 2010, the Company did not have any foreign currency forward contracts with an original maturity greater than twelve months.

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(Unaudited)

The hedges of foreign currency denominated forecasted revenues are accounted for in accordance with Accounting Standards Codification (ASC 815), pursuant to which the Company has designated its hedges of forecasted foreign currency revenues as cash flow hedges. The Company s designated cash flow hedges de-designate when the anticipated revenues associated with the transactions are recognized and the effective portion in Accumulated other comprehensive income (loss) is reclassified to revenues. Subsequent changes in fair value of the derivative instrument are recorded in Selling, general and administrative expenses to offset changes in fair value of the resulting non-functional currency receivables. For derivative instruments that are designated and qualified as cash flow hedges under ASC 815, the Company formally documents for each derivative instrument at the hedge s inception the relationship between the hedging instrument (foreign currency forward contract) and hedged item (forecasted foreign currency revenues), the nature of the risk being hedged, as well as its risk management objective and strategy for undertaking the hedge. The Company records the effective portion of the gain or loss on the derivative instrument designated and qualified as cash flow hedges in Accumulated other comprehensive income (loss) and reclassifies these amounts into Revenues in the period during which the hedged transaction is recognized in earnings. The Company assesses hedge effectiveness both at the onset of the hedge and on an ongoing basis using regression analysis. The Company measures hedge ineffectiveness by comparing the cumulative change in the fair value of the effective component of the hedge contract with the cumulative change in the fair value of the hedged item. The Company recognizes any over performance of the derivative as ineffectiveness in Revenues, and amounts not included in the assessment of effectiveness in Cost of revenues in the Condensed Consolidated Statements of Earnings. During the three months ended December 31, 2010 and January 1, 2010, the Company did not discontinue any cash flow hedges that had a material impact on the Company s results of operations. At the inception of the hedge, the Company assesses whether the likelihood of meeting the forecasted cash flow is highly probable. As of December 31, 2010, all forecasted cash flows were still probable to occur. As of December 31, 2010, net unrealized loss on derivative instruments of $0.4 million, before tax, was included in Accumulated other comprehensive income (loss), and is expected to be reclassified to net earnings over the twelve months that follow.

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

(In millions)	Notional Value Sold December 31, 2010
Japanese Yen	$ 10.1

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

	Gain (Loss) Recognized in Other Comprehensive Income (Effective Portion) Three Months Ended			Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Net Earnings (Effective Portion) Three Months Ended	
(in millions)	December 31, 2010	January 1, 2010	Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Net Earnings (Effective Portion)	December 31, 2010	January 1, 2010
Foreign exchange contracts	$ (0.5)	$ 1.2	Revenues	$ (0.6)	$

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(Unaudited)

The following table presents the amounts recognized in the Condensed Consolidated Statements of Earnings that are related to (i) the ineffective portion of the cash flow hedges and (ii) the amount excluded from effectiveness testing of the cash flow hedges:

		Three Months Ended	
(in millions)	**Location of Gain (Loss) Recognized**	**December 31, 2010**	**January 1, 2010**
Ineffective portion of cash flow hedges - Gain (Loss)	Revenues	$	$
Amount excluded from assessment of effectiveness of cash flow hedges - Gain (Loss)	Cost of Revenues	$	$

Balance Sheet Hedging Activities

The Company also hedges balance sheet exposures from its various subsidiaries and business units where the U.S. dollar is the functional currency. The Company enters into foreign currency forward contracts to minimize the short-term impact of foreign currency fluctuations on monetary assets and liabilities denominated in currencies other than the U.S. dollar functional currency. The foreign currency forward contracts are short term in nature, typically with maturity of approximately one month, and are based on the net forecasted balance sheet exposure. These hedges of foreign-currency-denominated assets and liabilities do not qualify for hedge accounting treatment and are not designated as hedging instruments under ASC 815. For derivative instruments not designated as hedging instruments, changes in their fair values are recognized in Selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings. Changes in the values of these hedging instruments are offset by changes in the values of foreign-currency-denominated assets and liabilities. Variations from the forecasted foreign currency assets or liabilities, coupled with a significant currency movement, may result in a material gain or loss if the hedges are not effectively offsetting the change in value of the foreign currency asset or liability. Other than foreign exchange hedging activities, the Company has no other free-standing or embedded derivative instruments.

The Company had the following outstanding foreign currency forward contracts that were either (i) entered into to hedge balance sheet exposures from its various foreign subsidiaries and business units or (ii) were originally designated as cash flow hedges (primarily in Euro and Japanese Yen) and were subsequently de-designated when the forecasted revenues were recognized:

	At December 31, 2010	
(In millions)	**Notional Value Sold**	**Notional Value Purchased**
Australian Dollar	$ 26.4	$
British Pound	2.5	
Danish Krone		2.9
Euro	173.0	5.0
Indian Rupee	1.7	
Japanese Yen	69.5	
Swedish Krona	1.9	3.7
Swiss Franc		44.3
Totals	$ 275.0	$ 55.9

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

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

Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Net Earnings on Derivative Three Months Ended	
(In millions)	December 31, 2010	January 1, 2010
Selling, general and administrative expenses	$ 4.8	$ 3.6

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

Contingent Features

Certain of the Company s derivative instruments are subject to a master netting agreement which contains provisions that require the Company, in the event of a default, to settle the outstanding contracts in net liability positions by making settlement payments in cash or by setting off amounts owed to the counterparty against any credit support or collateral held by the counterparty. The counterparty s right of set-off is not limited to the derivative instruments and applies to other rights held by the counterparty. Pursuant to the master netting agreement, an event of default includes the Company s failure to pay the counterparty under the derivative instruments, voluntary or involuntary bankruptcy, the Company s failure to repay an aggregate of $25 million or more in debts, and deterioration of creditworthiness of the surviving entity when the Company merges or transfers its assets or liabilities to another entity. As of December 31, 2010 and October 1, 2010, the Company did not have significant outstanding derivative instruments with credit-risk-related contingent features that were in a net liability position.

10. COMMITMENTS AND CONTINGENCIES

Environmental Remediation Liabilities

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

The Company spent $0.2 million and $0.3 million (net of amounts borne by VI and VSEA) during the three months ended December 31, 2010 and January 1, 2010, respectively, on environmental cleanup costs, third-party claim costs, project management costs and legal costs.

Inherent uncertainties make it difficult to estimate the likelihood of the cost of future cleanup, third-party claims, project management and legal services for the CERCLA sites and one of the Company s past facilities. Nonetheless, as of December 31,

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

2010, the Company estimated that, net of VI s and VSEA s indemnification obligations, future costs associated with the CERCLA sites and this facility would range in total from $2.6 million to $7.4 million. The time frames over which these cleanup project costs are estimated vary, ranging from one year up to thirty years as of December 31, 2010. Management believes that no amount in that range is more probable of being incurred than any other amount and therefore accrued $2.6 million for these cleanup projects as of December 31, 2010. The accrued amount has not been discounted to present value due to the uncertainties that make it difficult to develop a single best estimate.

The Company believes it has gained sufficient knowledge to better estimate the scope and cost of monitoring, cleanup and management activities for its other past and present facilities. This, in part, is based on agreements with other parties and also cleanup plans approved by or completed in accordance with the requirements of the governmental agencies having jurisdiction. As of December 31, 2010, the Company estimated that the Company s future exposure, net of VI s and VSEA s indemnification obligations, for the costs at these facilities, and reimbursements of third party s claims for these facilities, ranged in total from $6.4 million to $36.6 million. The time frames over which these costs are estimated to be incurred vary, ranging from one year to thirty years as of December 31, 2010. As to each of these facilities, management determined that a particular amount within the range of estimated costs was a better estimate than any other amount within the range, and that the amount and timing of these future costs were reliably determinable. The best estimate within that range was $14.7 million at December 31, 2010. Accordingly, the Company has accrued $10.8 million for these costs, which represents the best estimate discounted at 4%, net of inflation. This accrual is in addition to the $2.6 million described in the preceding paragraph.

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

The Company evaluates its liability for investigation and cleanup costs in light of the obligations and apparent financial strength of potentially responsible parties and insurance companies with respect to which the Company believes it has rights to indemnity or reimbursement. The Company has asserted claims for recovery of environmental investigation and cleanup costs already incurred, and to be incurred in the future against various insurance companies and other third parties. The Company receives certain cash payments in the form of settlements and judgments from defendants, insurers and other third parties from time to time. The Company has also reached an agreement with an insurance company under which that insurer has agreed to pay a portion of the Company s past and future environmental-related expenditures. The Company recorded receivables from that insurer of $3.0 million at both December 31, 2010 and October 1, 2010, with the current portion included in Prepaid expenses and other current assets and the noncurrent portion included in Other assets in the Condensed Consolidated Balance Sheets. The Company believes that this receivable is recoverable because it is based on a binding, written settlement agreement with what appears to be a financially viable insurance company, and the insurance company has paid the Company s claims in the past.

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

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(Unaudited)

Acquisition-Related Commitments/Obligations

When the Company acquired ACCEL in January 2007, ACCEL was involved in a contract-related lawsuit, which the Company settled by agreeing to perform certain services for a fixed price contract (the Fixed Price Contract). As of October 2, 2009, the Company had a loss accrual of 7.6 million related to the Fixed Price Contract. In the first quarter of fiscal year 2010, the Company entered into a new contract (the New Contract) to perform certain services for a fixed price and the Company recorded a loss accrual of 0.9 million in connection with the New Contract. As of December 31, 2010, the balance of the loss accrual related to this contingency (the New Contract) was 0.2 million. If the actual costs related to the contingency exceed the estimated amount or if the estimated loss increases, the variances will be recognized in the Consolidated Statements of Earnings in the periods in which these variances arise.

Other Matters

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

11. RETIREMENT PLANS

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

	Three Months Ended	
(In thousands)	**December 31, 2010**	**January 1, 20 10**
Defined Benefit Plans		
Service cost	$ 874	$ 622
Interest cost	1,200	1,263
Expected return on plan assets	(1,173)	(1,246)
Amortization of prior service cost	38	37
Recognized actuarial loss	513	418
Net periodic benefit cost	$ 1,452	$ 1,094
Post-Retirement Benefit Plans		
Interest cost	$ 62	$ 79
Amortization of transition amount		18
Amortization of prior service cost	1	1
Recognized actuarial (gain) loss	13	16
Net periodic benefit cost	$ 76	$ 114

The Company made contributions to the defined benefit plans of $2.9 million during the three months ended December 31, 2010. The Company currently expects total contributions to the defined benefit plans for fiscal year 2011 will be approximately $7.0 million. The Company made contributions to the post-retirement benefit plans of $0.1 million during the three months ended December 31, 2010. The Company currently expects total contributions to the post-retirement benefit plans for fiscal year 2011 will be approximately $0.5 million.

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

Because amounts related to retirement plans of Research Instruments, which is classified as a discontinued operation, were not material for any period presented, the Company has not segregated them from continuing operations in this note. See Note 17, Discontinued Operations.

12. INCOME TAXES

The Company s effective tax rate was 29.6% for the three months ended December 31, 2010, compared to 33.7% for the same period of fiscal year 2010. The decrease in the Company s effective tax rate for the three-month period ended December 31, 2010 was primarily due to a net benefit for discrete items, primarily the release of certain liabilities for uncertain tax positions, including the expiration of the statutes of limitation in various jurisdictions and the favorable resolution of several income tax audits, and the benefit of the retroactive reinstatement of the federal research and development credit.

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

The total amount of unrecognized tax benefits did not change by a significant amount during the three months ended December 31, 2010; however, the amount of unrecognized tax benefits has increased as a result of positions taken during the current and prior years, and has decreased as a result of expirations of the statutes of limitation and audit settlements in various jurisdictions.

13. STOCKHOLDERS EQUITY

Stock Repurchase Program

During the three months ended December 31, 2010, the Company did not repurchase any VMS common stock. During the three months ended January 1, 2010, the Company paid $55.2 million to repurchase 1,250,000 shares of VMS common stock under a November 17, 2008 authorization by VMS s Board of Directors. All shares that were repurchased have been retired. As of December 31, 2010, 4,461,751 shares of VMS common stock remained available for repurchase under an authorization that expires on September 30, 2011. Shares may be repurchased in the open market, in privately negotiated transactions or under Rule 10b5-1 share repurchase plans, and may be made from time to time or in one or more large blocks, including accelerated share repurchase arrangements.

As of December 31, 2010, the Company had an outstanding accelerated share repurchase agreement executed on August 24, 2010 with BofA (the Repurchase Agreement). Pursuant to the Repurchase Agreement, the Company paid to BofA $225 million and BofA delivered 3,888,249 shares of VMS common stock, representing approximately 90% of the shares to be repurchased based on the closing price of VMS common stock of $52.08 on August 24, 2010. Under the terms of the Repurchase Agreement, the specific number of shares that the Company ultimately will repurchase is based on the volume weighted average share price of VMS common stock during the repurchase period, less a discount. The repurchase period will end on February 23, 2011, provided that beginning on December 20, 2010 BofA has the right to accelerate the end of the repurchase period. The Repurchase Agreement provides that at the completion of the repurchase period, depending on the volume weighted average share price of VMS common stock during the repurchase period, the Company may be entitled to receive additional shares of VMS common stock from BofA or the Company may be required to deliver VMS shares or, at its option, make a cash payment to BofA. The remaining $22.5 million, representing approximately 10% of the cash payment to BofA, was recorded as an equity forward contract, which was included in Capital in excess of par value in the Condensed Consolidated Balance Sheet at December 31, 2010.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

Comprehensive Earnings

The components of comprehensive earnings are as follows:

	Three Months Ended	
(In thousands)	**December 31, 2010**	**January 1, 2010**
Net earnings	**$ 96,489**	**$ 78,775**
Other comprehensive income (loss), net of tax:		
Defined benefit pension and post-retirement benefit plans:		
Amortization of transition obligation included in net periodic benefit cost		11
Amortization of prior service cost included in net periodic benefit cost	34	33
Amortization of net actuarial loss included in net periodic benefit cost	413	331
	447	375
Unrealized gain on derivatives:		
Increase (decrease) in unrealized gain	(315)	716
Reclassification adjustments	403	(14)
	88	702
Currency translation adjustment	(4,455)	(1,666)
Other comprehensive loss	**(3,920)**	**(589)**
Total comprehensive earnings	**$ 92,569**	**$ 78,186**

Because amounts related to Research Instruments, which is classified as a discontinued operation, were not material for any period presented, the Company has not segregated them from continuing operations in this note. See Note 17 Discontinued Operations for a detailed discussion.

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

14. EMPLOYEE STOCK PLANS

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

(In thousands, except per share amounts)	Three Months Ended December 31, 2010	Three Months Ended January 1, 2010
Cost of revenues - Product	$ 549	$ 891
Cost of revenues - Service contracts and other	780	659
Research and development	1,725	1,071
Selling, general and administrative	9,510	6,224
Taxes on earnings	(4,284)	(3,133)
Net decrease in net earnings	$ 8,280	$ 5,712
Increase (decrease) on:		
Cash flows from operating activities (1)	$ (9,236)	$ (1,430)
Cash flows from financing activities (1)	$ 9,236	$ 1,430

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

During the three months ended December 31, 2010, total share-based compensation expense recognized in earnings before taxes was $12.6 million and the total related recognized tax benefit was $4.3 million. During the three months ended January 1, 2010, total share-based compensation expense recognized in earnings before taxes was $8.8 million and the total related recognized tax benefit was $3.1 million. Total share-based compensation expense capitalized as part of inventory for the three months ended December 31, 2010 was $0.8 million. Total share-based compensation expense capitalized as part of inventory for the three months ended January 1, 2010 was $0.2 million.

The fair value of options granted was estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions:

	Three Months Ended December 31, 2010	Three Months Ended January 1, 2010
Employee Stock Option Plans		
Expected term (in years)	4.69	4.42
Risk-free interest rate	1.3%	2.0%
Expected volatility	35.6%	37.6%
Expected dividend		
Weighted average fair value at grant date	$ 20.49	$ 15.27

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(Unaudited)

In May 2009, as part of a broader set of cost control initiatives, VMS s Board of Directors authorized the suspension of the Company s employee stock purchase plan in fiscal year 2010. A new employee stock purchase plan was introduced in the three months ended December 31, 2010. The option component of employee stock purchase plan shares for the three months ended December 31, 2010 was estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions:

	December 31, 2010	January 1, 2010
Employee Stock Purchase Plan		
Expected term (in years)	0.50	
Risk-free interest rate	0.2%	
Expected volatility	11.2%	
Expected dividend		
Weighted average fair value at grant date	$ 11.41	

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

		Options Outstanding			
(In thousands, except per share amounts)	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (3)
Balance at October 1, 2010	8,407	10,174	$ 44.03		
Granted (1)	(15)	7	64.01		
Cancelled or expired (2)	14	(1)	40.69		
Exercised		(1,890)	40.63		
Balance at December 31, 2010	8,406	8,290	$ 44.82	4.6	$ 202,746
Exercisable at December 31, 2010		6,739	$ 43.92	4.3	$ 170,881

(1) The difference between the number of shares granted listed in the column headed Shares Available for Grant and the number of shares granted listed in the column headed Options Outstanding Number of Shares represents the awards of restricted stock units. Restricted stock unit awards were counted against the shares available for grant limit as 2.5 shares for every one awarded.

(2) The difference between the number of cancelled or expired shares listed in the column headed Shares Available for Grant and the number of cancelled or expired shares listed in the column headed Options Outstanding Number of Shares represents the cancellation of shares of restricted common stock and restricted stock units due to employee terminations.

(3) The aggregate intrinsic value represents the total pre-tax intrinsic value, which is computed based on the difference between the exercise price and VMS s closing common stock price of $69.28 as of December 31, 2010, that last trading date of the first quarter of fiscal year 2011, and which would have been received by the option holders had all option holders exercised and sold their options as of that date.

As of December 31, 2010, there was $15.5 million of total unrecognized compensation expense related to outstanding stock options. This unrecognized compensation expense is expected to be recognized over a weighted average period of 1.7 years.

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

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

(In thousands, except per share amounts)	Shares	Weighted Average Grant-Date Fair Value
Balance at October 1, 2010	1,333	$ 46.91
Granted	3	64.01
Vested	(3)	48.28
Cancelled or expired	(6)	48.22
Balance at December 31, 2010	1,327	$ 46.95

As of December 31, 2010, unrecognized compensation expense totaling $34.5 million was related to restricted stock, restricted stock units and deferred stock units. This unrecognized compensation expense is expected to be recognized over a weighted average period of 2.0 years.

15. EARNINGS PER SHARE

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

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

(In thousands, except per share amounts)	Three Months Ended December 31, 2010	Three Months Ended January 1, 2010
Net earnings	$ 96,489	$ 78,775
Basic weighted average shares outstanding	118,170	123,690
Dilutive effect of potential common shares	3,042	1,371
Diluted weighted average shares outstanding	121,212	125,061
Net earnings per share - basic:	$ 0.82	$ 0.64
Net earnings per share - diluted:	$ 0.80	$ 0.63

The Company excludes shares underlying stock options from the computation of diluted weighted average shares outstanding if the per share value, either the exercise price of the options or the sum of (a) the exercise price of the options and (b) the amount of the compensation cost attributed to future services and not yet recognized and (c) the amount of tax benefit or shortfall that would be recorded in additional paid-in capital when the award becomes deductible, is greater than the average market price of the shares, because the inclusion of the shares underlying these stock options would be antidilutive to earnings per share. Based on this calculation, stock options to purchase 640,610 shares at an average exercise price of $52.95 per share were excluded from the computation of diluted weighted average shares outstanding for the three months

ended December 31, 2010. For the three months ended January 1, 2010, stock options to purchase 5,992,106 shares at an average exercise price of $49.49 per share were excluded from the computation of diluted weighted average shares outstanding.

16. SEGMENT INFORMATION

The Company s operations are grouped into two reportable operating segments: Oncology Systems and X-ray Products. These reportable operating segments were determined based on how the Company s Chief Executive Officer, its Chief

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

Operating Decision Maker (CODM), views and evaluates the Company s operations. The Company s Ginzton Technology Center (GTC), SIP business and Varian Particle Therapy (previously known as ACCEL Proton Therapy) are reflected in the Other category because these operating segments do not meet the criteria of a reportable operating segment. The CODM allocates resources to and evaluates the financial performance of each operating segment primarily based on operating earnings.

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

	Three Months Ended	
(In millions)	December 31, 2010	January 1, 2010
Revenues		
Oncology Systems	$ 452	$ 430
X-ray Products	112	91
Total reportable segments	$ 564	$ 521
Other	16	20
Total company	$ 580	$ 541
Operating Earnings (Loss)		
Oncology Systems	$ 120	$ 102
X-ray Products	30	23
Total reportable segments	$ 150	$ 125
Other	(8)	(11)
Corporate	(5)	5
Total company	$ 137	$ 119

17. DISCONTINUED OPERATIONS

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

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

The Company did not recognize any revenues in discontinued operations for the three months ended December 31, 2010. Total revenues of Research Instruments, reported in discontinued operations, for the three months ended January 1, 2010 were $0.1 million. Research Instruments did not have any profit or loss for either of the three months ended December 31, 2010 or January 1, 2010. As of December 31, 2010, the Company retained one Research Instruments customer contract, which is accounted for under the percentage-of-completion method, under which revenues and costs of sales are adjusted to reflect changes in estimated costs to complete the contracts. The percentage-of-completion method involves considerable use of estimates. If the estimated loss to complete or settle the remaining contract increases, the variance will be recognized in the periods these variances arise.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and

Stockholders of Varian Medical Systems, Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Varian Medical Systems, Inc. and its subsidiaries (the Company) as of December 31, 2010 and the related condensed consolidated statements of earnings for the three-month periods ended December 31, 2010 and January 1, 2010 and the condensed consolidated statements of cash flows for the three-month periods ended December 31, 2010 and January 1, 2010. These interim financial statements are the responsibility of the Company s management.

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

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

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of October 1, 2010, and the related consolidated statements of earnings, of stockholders equity and of cash flows for the year then ended (not presented herein), and in our report dated November 23, 2010, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of October 1, 2010, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP

San Jose, CA
February 9, 2011

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

Forward-Looking Statements

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

Overview

In the first quarter of fiscal year 2011, net earnings per diluted share increased 27% and revenues from continuing operations grew 7%, each over the year-ago quarter. Gross margin in the first quarter of fiscal year 2011 improved 1.4 percentage points over the year-ago period due primarily to a favorable product mix in Oncology Systems sales and higher shipment volumes in X-ray Products. Oncology Systems net orders grew in double digits in North America during the first quarter of fiscal year 2011 compared to the year-ago quarter, but declined in the international region primarily due to a steep net order decline in Japan, where a supplemental spending program contributed to record orders levels in the year-ago period. X-ray Products net orders also grew in double digits for the quarter over the year-ago quarter. Our backlog at the end of the first quarter of fiscal year 2011 was $2.2 billion, 10% higher than the end of the year-ago quarter. We ended the first quarter of fiscal year 2011 with $704 million of cash and cash equivalents.

Effective in the fourth quarter of fiscal year 2008, we classified our scientific research instruments business (Research Instruments) as a discontinued operation for all periods presented in our Condensed Consolidated Statements of Earnings. Research Instruments was previously included in the Other category. Unless otherwise stated, the discussion in this MD&A pertains to our continuing operations. Research Instruments did not have revenues and earnings in the first quarter of fiscal year 2011.

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

In our view, the fundamental market forces that drive long-term growth in our Oncology Systems business are the rising cancer incidence; technology advances and product developments that are leading to improvements in patient care; customer demand for more advanced and effective cancer treatments, such as fixed field IMRT, IGRT, stereotactic radiosurgery, brachytherapy and VMAT; competitive conditions among hospitals and clinics to offer such advanced treatments; continued improvement in safety and cost efficiency in delivering radiation therapy; and underserved medical needs outside of the United States. Our primary goal in the Oncology Systems business is to promote the adoption of more advanced and effective cancer treatments. We do not know what impact the Affordable Health Care for America Act will have on long-term growth or demand for our products and services.

In the second quarter of fiscal year 2010, we introduced the TrueBeam™ system for image-guided radiotherapy and radiosurgery. This product line is a fully-integrated system designed from the ground up to treat a moving target with higher speed and accuracy. Including a small portion of TrueBeam orders representing upgrades from other linear accelerators

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already in our backlog, through December 31, 2010 we had received orders for more than 170 TrueBeam systems since its introduction, a majority of which came from North America. We believe TrueBeam will be a valuable tool for clinicians in the fight against cancer and we expect it will stimulate stronger demand for our surgical products, as well as faster replacement of older systems in our installed base.

Oncology Systems net orders increased 5%, or 6% on a constant currency basis, in the first quarter of fiscal year 2011 over the first quarter of fiscal year 2010. The increase in North American Oncology Systems net orders was partially offset by a decrease in Oncology Systems net orders in the international region, which was driven primarily by a steep decline in net orders in Japan. Increased demand for our linear accelerators, which was driven by demand for the new TrueBeam system and, for software upgrades contributed to the growth in total Oncology Systems net orders. The first quarter of fiscal year 2011 marked Oncology Systems third consecutive quarter of double-digit net order growth in North America over the respective year-ago period. Continuing growth in demand for our Oncology Systems products depends in part on the strength and sustainability of an economic recovery in the United States. In addition, the adoption of government programs that stimulate the purchase of healthcare products, such as the one adopted in Japan, could affect the demand for our products from period to period, and could therefore make it difficult to compare our financial results.

In the first quarter of 2011, Oncology Systems total revenues rose 5% over the first quarter of 2010, primarily because of continued growth in service contract revenues. Oncology Systems recorded a 4% decrease in North American revenues in the first quarter of fiscal year 2011 over the first quarter of fiscal year 2010 and a 13% increase in international revenues. Oncology Systems gross margin in the first quarter of fiscal year 2011 improved from the first quarter of fiscal year 2010 as the increase in product gross margin more than offset the decrease in service contract gross margin.

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

Compared to the first quarter of fiscal year 2010, X-ray Products net orders increased 13% in the first quarter of fiscal year 2011. An increase in North American orders was partially offset by a decline in the international region. X-ray Products experienced double-digit growth in both North American and international revenues in the first quarter of fiscal year 2011 over the first quarter of fiscal year 2010, driven by growth in both x-ray tubes and flat panel detectors. X-ray Products gross margin for the first quarter of fiscal year 2011 increased more than one percentage point over the first quarter of fiscal year 2010 as a result of higher sales volume as well as improved costs of quality. In January 2011, we entered into a three-year agreement to supply medical imaging subcomponents to Toshiba Medical Systems, which has been one of our key customers in X-ray Products. We expect the value of this agreement to be approximately $450 million. Similar to contracts we have had with Toshiba Medical Systems in prior years, orders will be booked as they are placed over the term of the agreement.

Our success in our X-ray Products business depends upon our ability to anticipate changes in our markets, the direction of technological innovation and the demands of our customers. In addition, changes in access to diagnostic radiology or the reimbursement rates associated with diagnostic radiology as a result of the Affordable Health Care for America Act and similar state proposals will likely affect demand for our products.

Other. The Other category is comprised of Security and Inspections Products (SIP), the Varian Particle Therapy business, and the operations of the Ginzton Technology Center (GTC). (Please refer to Note 16, Segment Information to the Condensed Consolidated Financial Statements within this Quarterly Report on Form 10-Q) .

SIP designs, manufactures, sells and services Linatron® x-ray accelerators, imaging processing software and image detection products (including IntellX™) for cargo screening and border protection needs. Orders and revenues for our SIP products have been and may continue to be unpredictable as governmental agencies may place large orders in a short time period, and then may not place any orders for a long time period thereafter.

Our Varian Particle Therapy business develops, designs, manufactures, sells and services products and systems for delivering proton therapy, another form of external beam radiotherapy using proton beams, for the treatment of cancer. Although proton therapy has been in clinical use for more than four decades, it has not been widely deployed due to high capital cost. We are investing substantial resources to commercialize this technology and to build this new business. We currently have one

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proton therapy system being commissioned at a customer facility in Munich, Germany and, as of the end of the first quarter of fiscal year 2011, four treatment gantries at the facility were treating patients. We currently have a Conformité Européenne (CE) mark to market our proton therapy systems within the European Economic Area (EEA). In January 2011, we received 510(k) clearance in the United States for our proton therapy system, which is capable of delivering precise intensity modulated proton therapy (IMPT) using pencil beam scanning technology.

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

In the first quarter of fiscal year 2011, net orders in the Other category increased from the year-ago quarter when we reversed a $62 million proton therapy system order from Skandion Kliniken in Sweden when the Swedish court ruled that the tender should be recommenced following an appeal from a competitor and Skandion Kliniken s cancellation of the award. After Skandion Kliniken announced the award of the re-tender for its proton therapy facility to a competitor, we were unsuccessful in appealing the award and have dropped further litigation in this matter. For our Varian Particle Therapy business, we will only recognize orders with contingencies if we deem the contingencies perfunctory or if we publicly disclose the existence and nature of material contingencies. In addition, we will not recognize orders for Varian Particle Therapy products if there are major financing contingencies or customer board approval contingencies, pending. Revenues in the Other category decreased in the first quarter of fiscal year 2011 from the year-ago quarter primarily due to a decrease in Varian Particle Therapy service revenues related to the commissioning of a proton therapy system. In January 2011, SIP booked a $21 million order from U.S. Customs and Border Protection for five of our IntellX cargo screening systems after bid award challenges from competitors were dropped.

This discussion and analysis of our financial condition and results of operations is based upon and should be read in conjunction with the Condensed Consolidated Financial Statements and the notes included elsewhere in this Quarterly Report on Form 10-Q and the Consolidated Financial Statements and the Notes to the Consolidated Financial Statements and the related Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended October 1, 2010 (the 2010 Annual Report), as well as the Risk Factors contained in Part II, Item 1A of this Quarterly Report on Form 10-Q, and other information provided from time to time in our other filings with the SEC.

Critical Accounting Estimates

The preparation of our financial statements and related disclosures in conformity with accounting principles generally accepted in the United States (GAAP) requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and assumptions are based on historical experience and on various other factors that we believe are reasonable under the circumstances. We periodically review our accounting policies, estimates and assumptions and make adjustments when facts and circumstances dictate. In addition to the accounting policies that are more fully described in the Notes to the Consolidated Financial Statements included in our 2010 Annual Report, we consider the critical accounting policies described below to be affected by critical accounting estimates. Our critical accounting policies that are affected by accounting estimates include revenue recognition, share-based compensation expense, valuation of allowance for doubtful accounts, valuation of inventories, assessment of recoverability of goodwill and intangible assets, valuation of warranty obligations, assessment of environmental remediation liabilities, valuation of defined benefit pension and post-retirement benefit plans, valuation of derivative instruments and taxes on earnings. Such accounting policies require us to use judgments, often as a result of the need to make estimates and assumptions regarding matters that are inherently uncertain; and actual results could differ materially from these estimates. For a discussion of how these estimates and other factors may affect our business, see Part II, Item 1A, Risk Factors.

Revenue Recognition

We frequently enter into sales arrangements with customers that contain multiple elements or deliverables such as hardware, software and services. Judgments as to the allocation of consideration from an arrangement to the multiple elements of the arrangement, and the appropriate timing of revenue recognition are critical with respect to these arrangements to ensure compliance with GAAP.

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At the beginning of the second quarter of fiscal year 2010, we elected to early adopt the amended software revenue guidance and amended multiple deliverable revenue arrangement guidance on a prospective basis as of the beginning of fiscal year 2010 and have applied the amended guidance for revenue arrangements originating or materially modified after October 2, 2009. Under the amended guidance, the allocation of consideration in a multiple element arrangement is affected by the determination of whether any software deliverables that function together with other hardware components to deliver the hardware products essential functionality is considered as non-software products for the purpose of revenue recognition. The allocation of consideration to each non-software deliverable is based on the assumptions we use to establish its selling price, which are based on vendor-specific objective evidence (VSOE) of selling price, if it exists, otherwise, third-party evidence of selling price, if it exists, and if not on estimated selling prices. In addition, the allocation of consideration to each software deliverable in a multiple element arrangement is affected by our judgment as to whether VSOE of its fair value exists in these arrangements.

Under the prior authoritative guidance, the allocation of consideration to each deliverable in a multiple deliverable arrangement was affected by our judgment as to whether objective and reliable evidence of fair value existed for hardware deliverables and VSOE of the fair value existed for software deliverables in these arrangements.

Changes to the elements in an arrangement and the amounts allocated to each element could affect the timing and amount of revenue recognition. Revenue recognition also depends on the timing of shipment and is subject to customer acceptance and the readiness of customers facilities. If shipments are not made on scheduled timelines or if the products are not accepted by the customer in a timely manner, our reported revenues may differ materially from expectations.

In addition, revenues related to certain proton therapy commissioning service contracts and highly customized image detection systems are recognized under the percentage-of-completion method. Under the percentage-of-completion method of accounting, sales and gross profit are recognized as work is performed, based on the relationship between actual costs incurred and total estimated costs at the completion of the contract. Because the percentage-of-completion method involves considerable use of estimates in determining revenues, costs and profits and in assigning the dollar amounts to relevant accounting periods, and because the estimates must be periodically reviewed and appropriately adjusted, if our estimates prove to be inaccurate or circumstances change over time, we may be forced to adjust revenues or even record a contract loss in later periods. If a loss is expected on a contract under the percentage-of-completion method or completed contract method, the estimated loss would be charged to cost of sales in the period the loss is identified.

Share-based Compensation Expense

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

The expected term is based on the observed and expected time to post-vesting exercise and post-vesting cancellations of stock options by our employees. We determined the expected term of stock options based on the demographic grouping of employees and retirement eligibility. We used a combination of historical and implied volatility, or blended volatility, in deriving the expected volatility assumption. Blended volatility represents the weighted average of implied volatility and historical volatility. Implied volatility is derived based on traded options on VMS common stock. Implied volatility is weighted in the calculation of blended volatility based on the ratio of the term of the exchange-traded options to the expected terms of the employee stock options. Historical volatility represents the remainder of the weighting. Our decision to incorporate implied volatility was based on our assessment that implied volatility of publicly traded options on VMS common stock is reflective of market conditions and is generally reflective of both historical volatility and expectations of how future volatility will differ from historical volatility. In determining the extent of use of implied volatility, we considered: (i) the volume of market activity of traded options; (ii) the ability to reasonably match the input variables of traded options to those of stock options granted by us, including the date of grant; (iii) the similarity of the exercise prices; and (iv) the length of term of traded options. After considering the above factors, we determined that we could not rely exclusively on implied volatility based on the fact that the term of VMS exchange-traded options is less than one year and that it is different from the expected terms of the stock options we grant. Therefore, we believe a combination of the historical volatility over the expected terms of the stock options we grant and the implied volatility of exchange-traded options best reflects the expected volatility of VMS common stock. The risk-free interest rate assumption is based upon observed interest rates appropriate for the term of our stock options. The dividend yield assumption is based on our history

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and expectation of no dividend payouts. If factors change and we employ different assumptions in future periods, the compensation expense that we record may differ significantly from what we have recorded in the current period. In addition, we are required to estimate the expected forfeiture rate and recognize expense only for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the stock-based compensation expense could be significantly different from what we have recorded in the current period.

Allowance for Doubtful Accounts

We evaluate the creditworthiness of our customers prior to authorizing shipment for all major sale transactions. Except for government tenders, group purchases and orders with letters of credit in Oncology Systems, SIP and Varian Particle Therapy, and orders in our X-ray Products business, our payment terms usually require payment of a small portion of the total amount due when the customer signs the purchase order, a significant amount upon transfer of risk of loss to the customer and the remaining amount upon completion of the installation. On a quarterly basis, we evaluate aged items in the accounts receivable aging report and provide an allowance in an amount we deem adequate for doubtful accounts. If our evaluation of our customers financial conditions does not reflect our future ability to collect outstanding receivables, additional provisions may be needed and our operating results could be negatively affected.

Inventories

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

Goodwill and Intangible Assets

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

In accordance with Accounting Standard Codification (ASC) 350, we evaluate goodwill for impairment at least annually or whenever an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The impairment test for goodwill is a two-step process. Step one consists of a comparison of the fair value of a reporting unit against its carrying amount, including the goodwill allocated to each reporting unit. We determine the fair value of our reporting units based on the present value of estimated future cash flows of the reporting units. If the carrying amount of the reporting unit is in excess of its fair value, step two requires the comparison of the implied fair value of the reporting unit s goodwill against the carrying amount of the reporting unit s goodwill. Any excess of the carrying value of the reporting unit s goodwill over the implied fair value of the reporting unit s goodwill is recorded as an impairment loss. The impairment test for intangible assets with indefinite useful lives, if any, consists of a comparison of fair value to carrying value, with any excess of carrying value over fair value being recorded as an impairment loss. Based on the most recent annual goodwill impairment testing that we performed in the fourth quarter of fiscal year 2010 for each of our four reporting units with goodwill (Oncology Systems, X-ray Products, SIP and Varian Particle Therapy), the fair value of each such reporting unit was substantially in excess of its carrying value. We will continue to make assessments of impairment on an annual basis in the fourth quarter of our fiscal years or more frequently if indicators of potential impairment arise.

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Warranty Obligations

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

Environmental Matters

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

Defined Benefit Pension and Post-Retirement Benefit Plans

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

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

Valuation of Derivative Instruments

We use foreign currency forward contracts to reduce the effects of currency fluctuations on sales transactions denominated in foreign currencies and on assets and liabilities denominated in foreign currencies. These foreign currency forward contracts are derivative instruments and are measured at fair value. ASC 820 establishes three levels of inputs that may be used to measure fair value (see Note 3, Fair Value Measurements of the Notes to the Condensed Consolidated Financial Statements). Each level of input has different levels of subjectivity and difficulty involved in determining fair value. The fair value of foreign currency forward contracts are calculated primarily using Level 2 inputs, which include currency spot and forward rates, interest rate and credit or non-performance risk. The spot rate for each currency is the same spot rate used for all balance sheet translations at the measurement date and sourced from our major trading banks. The forward point values

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for each currency and the London Interbank Offered Rate (LIBOR) to discount assets and liabilities are interpolated from commonly quoted broker services. One year credit default swap spreads of the counterparty at the measurement date are used to adjust derivative assets, all of which mature in less than 12 months, for non-performance risk. We are required to adjust derivative liabilities to reflect the potential non-performance risk to lenders based on our incremental borrowing rate. Each contract is individually adjusted using the counterparty s discount rate (for net asset) or our discount rate (for net liability). The use of Level 2 inputs in determining fair values requires certain management judgment and subjectivity. Changes to these Level 2 inputs could have a material impact to the valuation of our derivative instruments, as well as on our results of operations.

Taxes on Earnings

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

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

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

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

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Results of Operations

Fiscal Year

Our fiscal year is the 52- or 53-week period ending on the Friday nearest September 30. Fiscal year 2011 is the 52-week period ending September 30, 2011, and fiscal year 2010 was the 52-week period ended October 1, 2010. The fiscal quarters ended December 31, 2010 and January 1, 2010 were both 13-week periods.

Discussion of Results of Operations for the First Quarter of Fiscal Year 2011 Compared to the First Quarter of Fiscal Year 2010

Total Revenues

Revenues by sales classification	**Three Months Ended**		
(Dollars in millions)	**December 31, 2010**	**January 1, 2010**	**Percent Change**
Product	$ 431.8	$ 410.2	5%
Service Contracts and Other	148.1	130.7	13%
Total Revenues	$ 579.9	$ 540.9	7%
Product as a percentage of total revenues	*74%*	*76%*	
Service Contracts and Other as a percentage of total revenues	*26%*	*24%*	
Revenues by region			
North America	$ 223.0	$ 227.8	(2%)
Europe	203.8	193.0	6%
Asia	124.8	104.2	20%
Rest of world	28.3	15.9	78%
Total International (1)	356.9	313.1	14%
Total	$ 579.9	$ 540.9	7%
North America as a percentage of total revenues	*38%*	*42%*	
International as a percentage of total revenues	*62%*	*58%*	

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

The increase in revenues in the first quarter of fiscal year 2011 over the first quarter of fiscal year 2010 was due to revenue growth in Oncology Systems and X-ray Products, partially offset by declines in revenues in SIP and Varian Particle Therapy. X-ray Products and Oncology Systems contributed to the growth in product revenues, while SIP product revenues decreased. The increase in service contracts and other revenues was primarily driven by an increase in Oncology Systems service contract revenues partially offset by a decrease in Varian Particle Therapy service revenues.

North American revenues decreased in the first quarter of fiscal year 2011 from the first quarter of fiscal year 2010 primarily due to a decrease in Oncology Systems and SIP North American revenues, partially offset by an increase in X-ray Products North American revenues.

International revenues increased in the first quarter of fiscal year 2011 over the first quarter of fiscal year 2010, primarily due to increases in international revenues in Oncology Systems, X-ray Products and SIP, which were partially offset by a decline in Varian Particle Therapy international revenues. Overall, the U.S. dollar was stronger against foreign currencies in the first quarter of fiscal year 2011 compared to the first quarter of fiscal year 2010, which negatively affected our international revenues when measured in U.S. dollars.

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Oncology Systems Revenues

Revenues by sales classification (Dollars in millions)	Three Months Ended December 31, 2010	January 1, 2010	Percent Change
Product	$ 309.7	$ 306.4	1%
Service Contracts (1)	142.7	123.7	15%
Total Oncology Systems revenues	$ 452.4	$ 430.1	5%
Product as a percentage of total Oncology Systems revenues	*68%*	*71%*	
Service Contracts as a percentage of Oncology Systems revenues	*32%*	*29%*	
Oncology Systems revenues as a percentage of total revenues	*78%*	*79%*	

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

In the first quarter of fiscal year 2011, Oncology Systems product revenues increased slightly over the first quarter of fiscal year 2010 primarily due to an increase in revenues from sales of our software products. The increases in service contract revenues in the first quarter of fiscal year 2011 over the first quarter of fiscal year 2010 was primarily driven by increased customer adoption of service contracts as our products become more sophisticated and by an increased number of customers as the installed base of our products continues to grow.

Revenues by region (Dollars in millions)	Three Months Ended December 31, 2010	January 1, 2010	Percent Change
North America	$ 187.9	$ 196.7	(4%)
Europe	168.3	162.6	3%
Asia	69.2	56.1	23%
Rest of world	27.0	14.7	84%
Total International	264.5	233.4	13%
Total Oncology Systems revenues	$ 452.4	$ 430.1	5%
North America as a percentage of Oncology Systems revenues	*42%*	*46%*	
International as a percentage of Oncology Systems revenues	*58%*	*54%*	

Due to decreases in revenues in most product lines, North American Oncology Systems product revenues decreased in the first quarter of fiscal year 2011 over the first quarter of fiscal year 2010, although the decrease was partially offset by increased service contract revenues.

Oncology Systems international revenues grew in the first quarter of fiscal year 2011 over the first quarter of fiscal year 2010 primarily due to an increase in revenues from sales of our software products and an increase in service contracts revenues in all international regions. However, the overall stronger U.S. dollar against foreign currencies in the first quarter of fiscal year 2011 compared to the first quarter of fiscal year 2010 negatively affected our international revenues when measured in U.S. dollars.

Varying cycles of higher and lower revenues between the international and North American regions is a historical pattern reflecting regional influences such as the effects of the recession, uncertainty created by healthcare reform and reductions in Medicare reimbursement rates for radiotherapy and radiosurgery in the United States, and different technology adoption cycles that are consistent with the net order patterns discussed more fully under Net Orders.

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X-ray Products Revenues

Revenues by region (Dollars in millions)	Three Months Ended December 31, 2010	January 1, 2010	Percent Change
North America	$ 32.5	$ 27.6	18%
Europe	22.4	15.0	49%
Asia	55.4	47.6	17%
Rest of world	1.3	1.2	2%
Total International	79.1	63.8	24%
Total X-ray Products Revenues	$ 111.6	$ 91.4	22%
North America as a percentage of X-ray Products revenues	*29%*	*30%*	
International as a percentage of X-ray Products revenues	*71%*	*70%*	
X-ray Products revenues as a percentage of total revenues	*19%*	*17%*	

Both the international region and North America contributed to the increase in X-ray Products revenues in the first quarter of fiscal year 2011 over the first quarter of fiscal year 2010. The increase in North American X-ray Products revenues was primarily due to increased revenues from increased sales of our flat panel products, including our radiographic flat panels. Increased revenues from sales of both our flat panel products and x-ray tube products in Europe and Asia contributed to the increase in international X-ray Products revenues in the first quarter of fiscal year 2011 over the year-ago quarter.

Other Revenues

Revenues by sales classification (Dollars in millions)	Three Months Ended December 31, 2010	January 1, 2010	Percent Change
Product	$ 10.5	$ 12.4	(16%)
Service Contracts	5.4	7.0	(23%)
Total Other revenues	$ 15.9	$ 19.4	(19%)
Other revenues as a percentage of total revenues	*3%*	*4%*	

Revenues in our Other category, which is comprised of SIP, Varian Particle Therapy and GTC, decreased in the first quarter of fiscal year 2011 from the first quarter of fiscal year 2010 primarily due to a decrease in Varian Particle Therapy service revenues related to the commissioning of a proton therapy system and a decrease in SIP products revenues.

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Gross Margin

(Dollars in millions)	Three Months Ended December 31, 2010	Three Months Ended January 1, 2010	Percent Change
Dollar by segment			
Oncology Systems	$ 214.1	$ 200.2	7%
X-ray Products	47.1	37.6	25%
Other	5.6	3.2	72%
Gross margin	$ 266.8	$ 241.0	11%
Percentage by segment			
Oncology Systems	*47.3%*	*46.5%*	
X-ray Products	*42.3%*	*41.2%*	
Total Company	*46.0%*	*44.6%*	

The increase in total company gross margin percentage for the first quarter of fiscal year 2011 over the first quarter of fiscal year 2010 was primarily due to the improvements in Oncology Systems, X-ray Products, SIP and Varian Particle Therapy gross margins.

The increase in Oncology Systems gross margin was primarily due to an increase in Oncology Systems product gross margin as well as a higher proportion of Oncology Systems service contract revenues, which carry higher gross margins than Oncology Systems product revenues, even though service contract gross margin decreased in the first quarter of fiscal year 2011 from the year-ago quarter. For the first quarter of fiscal year 2011, Oncology Systems product gross margin was 45.0%, compared to 42.8% in the first quarter of fiscal year 2010, because of factors including improved installation and warranty costs and increased revenues associated with higher margin products (including our software upgrades, our TrueBeam system and our Trilogy® high energy linear accelerator) in both North America and the international region, especially Japan. Compared to an unusually high gross margin of 55.9% in the first quarter of fiscal year 2010, Oncology Systems service contract gross margin decreased to 52.5% in the first quarter of fiscal year 2011 primarily due to higher costs of quality.

For the first quarter of fiscal year 2011, X-ray Products gross margin improved over the first quarter of fiscal year 2010 primarily due to higher sales volume, as well as improved costs of quality for our x-ray tube products.

Research and Development

(Dollars in millions)	Three Months Ended December 31, 2010	Three Months Ended January 1, 2010	Percent Change
Research and development	$ 38.5	$ 38.4	0%
As a percentage of total revenues	*6.6%*	*7.1%*	

Research and development expenses for the first quarter of fiscal year 2011 were almost flat in dollars and decreased as a percent of revenue, compared to the first quarter of fiscal year 2010. An increase of $1.5 million in the Other category was significantly offset by a decrease of $1.2 million in Oncology Systems and a decrease of $0.2 million in X-ray Products. The increase in the Other category was primarily due to higher expense for development projects in Varian Particle Therapy and, to a lesser extent, an increase in SIP research and development expenses. The decrease in Oncology Systems was attributable primarily to a decrease in material costs and consulting expenses for product development, as well as a favorable impact when foreign-currency-denominated research and development expenses for Oncology Systems were translated into U.S. dollars in the first quarter of fiscal year 2011 compared to the first quarter of fiscal year 2010, when the U.S. dollar was relatively weaker against foreign currencies. The decrease in X-ray Products was mainly due to lower development expenses for flat panel products.

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Selling, General and Administrative

(Dollars in millions)	Three Months Ended December 31, 2010	Three Months Ended January 1, 2010	Percent Change
Selling, general and administrative	$ 91.3	$ 83.5	9%
As a percentage of total revenues	*15.7%*	*15.4%*	

The $7.8 million increase in selling, general and administrative expenses for the first quarter of fiscal year 2011 compared to the first quarter of fiscal year 2010 was primarily attributable to: (a) a $7.6 million net increase in expenses related to accruals for contingent legal liabilities; and (b) a $6.0 million increase in employee-related costs and headcount to support our growing business activities. These increases were partially offset by: (i) the inclusion in the year-ago period of an expense of $3.3 million related to an October 2009 reduction in force; (ii) a $1.8 million increase in net gain recognized on our equity investment in dpiX Holding LLC ; and (iii) a $1.7 million net increase in gain from derivatives used to hedge our balance sheet exposures from our various foreign subsidiaries and business units (a gain of $0.3 million in the first quarter of fiscal year 2011 compared to a loss of $1.4 million in the year-ago quarter).

Interest Income (Expense), Net

(Dollars in millions)	Three Months Ended December 31, 2010	Three Months Ended January 1, 2010	Percent Change
Interest income (expense), net	$ 0.1	$ (0.3)	n/a

In the first quarter of fiscal year 2011, the net increase in interest income, net of interest expense, over the first quarter of fiscal year 2010 was primarily due to lower average debt balances.

Taxes on Earnings

	Three Months Ended December 31, 2010	Three Months Ended January 1, 2010	Percent Change
Effective tax rate	29.6%	33.7%	(4.1%)

Our effective tax rate was 29.6% for the first quarter of fiscal year 2011, compared to 33.7% for the first quarter of fiscal year 2010. The decrease in our effective tax rate for the first quarter of fiscal year 2011 was primarily due to a net benefit for discrete items, primarily the release of certain liabilities for uncertain tax positions, including the expiration of the statutes of limitation in various jurisdictions and the favorable resolution of several income tax audits, and the benefit of the retroactive reinstatement of the federal research and development credit.

In general, our effective income tax rate differs from the U.S. federal statutory rate primarily because our foreign earnings are taxed at rates that are, on average, lower than the U.S. federal rate, and our domestic earnings are subject to state income taxes. Our future effective tax rate could be adversely affected by having lower earnings than anticipated in countries where we have lower statutory rates and higher earnings than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets or liabilities, and by changes in tax laws or interpretations of those laws. For example, recent proposals would make significant changes to U.S. taxation of U.S.-based multinational corporations. Although we cannot predict whether or in what form Congress would enact any such proposals, legislation of this type could have an adverse impact on our effective tax rate. We also expect that our effective tax rate may experience increased fluctuation from period to period under the provisions in ASC 740 related to accounting for uncertainty in income taxes. Please refer to further discussion in Note 12, Income Taxes of the Notes to the Consolidated Financial Statements in our 2010 Annual Report.

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Net Earnings Per Diluted Share

	Three Months Ended		
	December 31, 2010	January 1, 2010	Percent Change
Net earnings per diluted share	$ 0.80	$ 0.63	27%

The increase in earnings per diluted share in the first quarter of fiscal year 2011 over the first quarter of fiscal year 2010 resulted from (i) an increase in total revenues, (ii) an improvement in gross margin, (iii) a decrease in effective tax rate and (iv) a reduction in the number of diluted shares of common stock outstanding due mainly to the accelerated stock repurchase program that was executed in the fourth quarter of 2010.

Net Orders

Total Net Orders (by segment and region)	Three Months Ended		
(Dollars in millions)	**December 31, 2010**	**January 1, 2010**	**Percent Change**
Oncology Systems:			
North America	$ 229.0	$ 191.0	20%
Total International	230.0	245.5	(6%)
Total Oncology Systems	$ 459.0	$ 436.5	5%
X-ray Products:			
North America	$ 28.3	$ 10.7	166%
Total International	83.6	88.3	(5%)
Total X-ray Products	$ 111.9	$ 99.0	13%
Other:	$ 21.9	$ (39.9)	n/a
Total Net Orders:	$ 592.8	$ 495.6	20%

The growth in total Oncology Systems net orders in the first quarter of fiscal year 2011 was primarily due to the net order growth in North America, partially offset by the net order decline in the international region. On a constant currency basis, Oncology Systems net orders grew 6% in the first quarter of fiscal year 2011 over the first quarter of fiscal year 2010. The growth in North American Oncology Systems net orders, helped in part by strong net orders growth in Canada, was primarily due to increased demand for our high energy linear accelerators (including the TrueBeam system) and software upgrades. International Oncology Systems net orders decreased 6%, or 4% on a constant currency basis, in the first quarter of fiscal year 2011 from the first quarter of fiscal year 2010. The decrease in international Oncology Systems net orders was primarily due to decreased demand for our high energy linear accelerators in Asia, driven primarily by a steep decline in net orders in Japan, where a supplemental spending program contributed to record orders levels in the year-ago period. This decrease was partially offset by increased demand for software upgrades in all international regions.

The trailing 12 months growth in net orders for Oncology Systems at the end of the first quarter of fiscal year 2011 and at the end of the previous three fiscal quarters were: a 10% total increase, with a 11% increase in North America and an 10% increase for the international region, as of December 31, 2010; a 10% total increase, with a 4% increase in North America and an 16% increase for the international region, as of October 1, 2010; a 3% total increase, with a 10% decrease in North America and an 18% increase for the international region, as of July 2, 2010; flat for total net orders, with a 14% decrease in North America and an 18% increase for the international region, as of April 2, 2010. Consistent with the historical pattern, we expect that Oncology Systems net orders will continue to experience regional fluctuations. In addition, the adoption of government programs that stimulate the purchase of healthcare products, such as the one adopted in Japan, could affect the demand

for our products from period to period, and could therefore make it difficult to compare our financial results.

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In the first quarter of fiscal year 2011, North American X-ray Products net orders increased over the first quarter of fiscal year 2010. Increased demand for our flat panel products (including our radiographic flat panels) and, to a lesser extent, increased demand for our x-ray tubes contributed to the increase in North American X-ray Products net orders. The decline in international X-ray Products net orders was primarily due a decreased in demand for our flat panel products in Asia and Europe, partially offset by an increase in demand for our x-ray tubes in Asia and Europe.

Net orders in the Other category increased $62 million in the first quarter of fiscal year 2011 from the first quarter of fiscal year 2010 when we reversed a $62 million proton therapy system order from Skandion Kliniken in Sweden. Excluding the reversal of the proton therapy system order, net orders in the Other category were flat compared to the year-ago quarter.

As the U.S economy stabilizes, we could experience a temporary increase in orders due to pent-up demand of customers, which, in turn, could increase the volatility of our orders and revenues. Orders in any period may not be directly correlated to the level of revenues in any particular future quarter or period since the timing of revenue recognition will vary significantly based on the delivery requirements of individual orders, acceptance schedules and the readiness of individual customer sites for installation of our products. Moreover, certain types of orders, such as software or newly introduced products in our Oncology Systems segment, typically take more time from order to completion of installation and acceptance than hardware or older products.

Discontinued Operations

We sold Research Instruments in the second quarter of fiscal year 2009. Research Instruments has been classified as a discontinued operation in our Condensed Consolidated Statements of Earnings for all periods presented. Research Instruments was previously included in the Other category. We did not recognize any revenues in discontinued operations for the three months ended December 31, 2010. Total revenues of Research Instruments, reported in discontinued operations, for the three months ended January 1, 2010 were $0.1 million. Research Instruments did not have any profit or loss in the first quarters of fiscal year 2011 and fiscal year 2010. As of December 31, 2010, we retained one Research Instruments customer contract, which is accounted for under the percentage-of-completion method, under which revenues and costs of sales are adjusted to reflect changes in estimated costs to complete the contracts. The percentage-of-completion method involves considerable use of estimates. If the estimated loss to complete or settle the remaining contract increases, the variance will be recognized in the periods these variances arise. See Note 17, Discontinued Operations to the Condensed Consolidated Financial Statements for a detailed discussion.

Backlog

At December 31, 2010, our backlog was $2.2 billion, which is an increase of 10% over the backlog at January 1, 2010. Our Oncology Systems backlog at December 31, 2010 was 12% higher than the backlog at January 1, 2010, which reflects a 14% increase for North America and an 8% increase for the international region.

Liquidity and Capital Resources

Liquidity is the measurement of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, acquire businesses, repurchase VMS stock, and fund continuing operations. Our sources of cash have included operations, borrowings, stock option exercises and employee stock purchases (although no purchases under our employee stock purchase plan were made during fiscal year 2010) and interest income. Our cash usage is actively managed on a daily basis to ensure the maintenance of sufficient funds to meet our needs. Because Research Instruments cash flows were not material for any period presented, we have not segregated them from continuing operations on our Consolidated Statements of Cash Flows and the discussion herein.

Cash and Cash Equivalents

The following table summarizes our cash and cash equivalents:

(In millions)	December 31, 2010	October 1, 2010	Increase/ (Decrease)
Cash and cash equivalents	$ 704	$ 520	$ 184

Our cash and cash equivalents increased $184 million from $520 million at October 1, 2010 to $704 million at December 31, 2010. The increase in cash and cash equivalents in the first quarter of fiscal year 2011 was due primarily to $138 million of

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cash generated from operating activities, $77 million of cash provided by stock option exercises and $9 million of cash provided by the excess tax benefits from share-based compensation. These increases were partially offset by $23 million of capital expenditures and $20 million of cash used in net payments under our credit facility. In addition, foreign currency exchange rate changes in the first quarter of fiscal year 2011 increased cash and cash equivalents by $2 million.

At December 31, 2010, we had approximately $138 million, or 20%, of total cash and cash equivalents in the United States. Approximately $566 million, or 80%, of total cash and cash equivalents was held abroad and could be subject to additional taxation if it were repatriated to the United States. As of December 31, 2010, most of our cash and cash equivalents that were held abroad were in U.S. dollars. Because our cash levels in the United States are relatively low, we have used our credit facilities to meet our cash needs from time to time and expect to continue to do so in the future. Borrowings under our credit facilities may be used for working capital, capital expenditures, stock repurchases, acquisitions and other corporate purposes.

Cash Flows

	Three Months Ended	
(In millions)	**December 31, 2010**	**January 1, 2010**
Net cash flow provided by (used in):		
Operating activities	$ 138	$ 131
Investing activities	(22)	(16)
Financing activities	66	(46)
Effects of exchange rate changes on cash and cash equivalents	2	2
Net increase in cash and cash equivalents	$ 184	$ 71

Our primary cash inflows and outflows for the first quarter of fiscal year 2011, as compared to the first quarter of fiscal year 2010, were as follows:

In the first quarter of fiscal year 2011, we generated net cash from operating activities of $138 million, compared to $131 million for the first quarter of fiscal year 2010. The $7 million increase in net cash from operating activities during the first quarter of fiscal year 2011 compared to the first quarter of fiscal year 2010 was driven primarily by an increase of $18 million in net earnings and an increase in non-cash items of $6 million partially offset by a net decrease of $17 million as a result of changes to operating assets and liabilities (working capital items) between the two quarters.

During the first quarter of fiscal year 2011, the major contributors to the net change in working capital items from fiscal year end 2010 were accounts receivable, inventories and accrued expenses as follows:

Accounts receivable decreased $92 million due to lower revenues in the first quarter of fiscal year 2011 compared to the fourth quarter of fiscal year 2010, as well as strong collection performance in the first quarter of fiscal year 2011. We historically experience higher fourth quarter revenues than in the following first quarter.

Inventories increased by $36 million due to anticipated customer demand for products during fiscal year 2011.

Accrued expenses decreased by $25 million primarily resulting from a decrease in accrued compensation and benefits due to timing of compensation payments.

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

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We used $23 million for investing activities in the first quarter of fiscal year 2011, compared to $16 million used in the first quarter of fiscal year 2010. Cash used for purchases of property, plant and equipment was $23 million for the first quarter of fiscal year 2011 and $8 million for the first quarter of fiscal year 2010. In the first quarter of fiscal year 2010, we also made an additional loan of $2 million.

Financing activities provided net cash of $66 million in the first quarter of fiscal year 2011 compared to $45 million of net cash used in the first quarter of fiscal year 2010. During the first quarter of fiscal year 2011, we received $77 million of proceeds from employee stock option exercises and $9 million in excess tax benefits from share-based compensation, partially offset by net repayments of $20 million under our credit facility. We did not use any cash to repurchase VMS common stock in the first quarter of fiscal year 2011. During the first quarter of fiscal year 2010, we used $55 million to repurchase shares of VMS common stock. Partially offsetting the use of cash to repurchase shares of VMS common stock during the first quarter of fiscal year 2010 were proceeds of $9 million from employee stock option exercises, and $1 million in excess tax benefits from share-based compensation.

We expect our capital expenditures, which typically represent construction and/or purchases of facilities, manufacturing equipment, office equipment and furniture and fixtures, as well as capitalized costs related to the implementation of software applications, will be approximately 3% of revenues in fiscal year 2011.

We have a $225 million credit facility with Bank of America, N.A. (BofA), which was amended and restated in November 2008 and then again amended in July 2009 and in August 2010. This credit facility, as amended to date, is referred to as the Amended BofA Credit Facility . A portion of the Amended BofA Credit Facility is collateralized with a pledge of stock of certain of VMS s present and future subsidiaries that are deemed to be material subsidiaries. As of December 31, 2010, VMS has pledged to BofA 65% of the voting shares that it holds in Varian Medical Systems Nederland B.V., a wholly-owned subsidiary. Under the Amended BofA Credit Facility, VMS s Japanese subsidiary (VMS KK) can borrow up to 2.7 billion Japanese Yen as part of the overall credit facility (the Japanese Line of Credit). At any time amounts are outstanding under the Japanese Line of Credit, the full borrowing capacity is deemed committed for use in Japan and therefore the maximum amount VMS can otherwise borrow under the Amended BofA Credit Facility will be reduced by $35 million to $190 million. VMS guarantees the payment of the outstanding balance under the Japanese Line of Credit.

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

As of December 31, 2010, there was no outstanding balance under the Amended BofA Credit Facility and during the first quarter of fiscal year 2011, the greatest amount outstanding under the Amended BofA Credit Facility (including the Japanese Line of Credit) was $20 million at the start of the quarter. Up to $25 million of the Amended BofA Credit Facility may also be used to support letters of credit issued on behalf of the Company, of which none were outstanding as of December 31, 2010.

The Amended BofA Credit Facility contains customary affirmative and negative covenants for facilities of this type. We have also agreed to maintain certain financial covenants relating to (i) leverage ratios involving funded indebtedness and EBITDA, (ii) liquidity and (iii) consolidated assets. As of December 31, 2010, we were in compliance with all covenants. See also Note 8 Credit Facility to the Condensed Consolidated Financial Statements for a discussion regarding the Amended BofA Credit Facility.

Our liquidity is affected by many factors, some of which result from the normal ongoing operations of our business and some of which arise from uncertainties and conditions in the United States and global economies. Although our cash requirements

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

Total debt as a percentage of total capital decreased to 1.6% at December 31, 2010 from 3.3% at October 1, 2010. The ratio of current assets to current liabilities increased to 2.12 to 1 at December 31, 2010 from 1.86 to 1 at October 1, 2010.

Days Sales Outstanding

Trade accounts receivable days sales outstanding (DSO) were 78 days at December 31, 2010 compared to 84 days at January 1, 2010. Our accounts receivable and DSO are impacted by a number of factors, primarily including: the timing of product shipments; collections performance; payment terms; and the mix of revenues from different regions. As of December 31, 2010, less than 1% of our accounts receivable balance was related to customer contracts with remaining terms of more than one year.

Stock Repurchase Program

During the three months ended December 31, 2010, we did not repurchase any VMS common stock. During the three months ended January 1, 2010, we paid $55.2 million to repurchase 1,250,000 shares of VMS common stock under the November 17, 2008 authorization by VMS s Board of Directors. All shares that were repurchased have been retired. As of December 31, 2010, 4,461,751 shares of VMS common stock remained available for repurchase under an authorization that expires on September 30, 2011. Shares may be repurchased in the open market, in privately negotiated transactions or under Rule 10b5-1 share repurchase plans, and may be made from time to time or in one or more large blocks, including accelerated share repurchase arrangements.

As of December 31, 2010, we had an outstanding accelerated share repurchase agreement executed on August 24, 2010 with BofA (the Repurchase Agreement). Pursuant to the Repurchase Agreement, we paid to BofA $225 million and BofA delivered 3,888,249 shares of VMS common stock, representing approximately 90% of the shares to be repurchased based on the closing price of VMS common stock of $52.08 on August 24, 2010. Under the term of the Repurchase Agreement, the specific number of shares that we ultimately will repurchase is based on the volume weighted average share price of VMS common stock during the repurchase period, less a discount. The repurchase period will end on February 23, 2011, provided that beginning on December 20, 2010 BofA has the right to accelerate the end of the repurchase period. The Repurchase Agreement provides that at the completion of the repurchase period, depending on the volume weighted average share price of VMS common stock during the repurchase period, we may be entitled to receive additional shares of VMS common stock from BofA or we may be required to deliver VMS shares or, at our option, make a cash payment to BofA. The remaining $22.5 million, representing approximately 10% of the cash payment to BofA, was recorded as an equity forward contract, which was included in Capital in excess of par value in the Condensed Consolidated Balance Sheet at December 31, 2010. The average price of VMS common stock during the repurchase period to date has exceeded $52.08 and we will likely be required to deliver cash or shares of VMS common stock to BofA in settlement of the Repurchase Agreement.

Contractual Obligations

Long-term income taxes payable includes the liability for uncertain tax positions (including interest and penalties) and may also include other long-term tax liabilities. As of December 31, 2010, our liability for uncertain tax positions was $55.1 million. We believe that existing cash and cash equivalents and cash to be generated from operations and current or future credit facilities will be sufficient to satisfy any payment obligations that may arise related to our liability for uncertain tax positions.

In February 2009, we agreed to loan up to $14 million to dpiX LLC (dpiX) in four separate installments over a period through the first half of fiscal year 2010, which period could be extended. As of December 31, 2010, we had loaned $8.8 million to dpiX under this loan agreement and we do not know the timing of the funding of the remaining $5.2 million. Please refer to the more detailed discussion in Note 6, Related Party Transactions to the Condensed Consolidated Financial Statements.

Except for the change in the outstanding balance under our credit facility and the other items discussed above, there has been no significant change to the other contractual obligations we reported in our 2010 Annual Report.

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Contingencies

Environmental Remediation Liabilities

For a discussion of environmental remediation liabilities, see Note 10, Commitments and Contingencies - Environmental Remediation Liabilities to the Condensed Consolidated Financial Statements, which discussion is incorporated herein by reference.

Acquisition-Related Commitments/Obligations

When we acquired ACCEL Instruments GmbH (ACCEL, which has since changed its name to Varian Medical Systems Particle Therapy GmbH) in January 2007, ACCEL was involved in a contract-related lawsuit, which we settled by agreeing to perform certain services for a fixed price contract (the Fixed Price Contract). As of October 2, 2009, we had a loss accrual of 7.6 million related to the Fixed Price Contract. In the first quarter of fiscal year 2010, we entered into a new contract (the New Contract) to perform certain services for a fixed price and we recorded a loss accrual of 0.9 million in connection with the New Contract. As of December 31, 2010, the balance of the loss accrual related to this contingency was 0.2 million. If the actual costs related to the contingency (the New Contract) exceed the estimated amount or if the estimated loss increases, the variances will be recognized in the Condensed Consolidated Statement of Earnings in the periods in which these variances arise.

Other Matters

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

Off-Balance Sheet Arrangements

In conjunction with the sale of our products in the ordinary course of business, we provide standard indemnification of business partners and customers for losses suffered or incurred for property damages, death and injury and for patent, copyright or any other intellectual property infringement claims by any third parties with respect to our products. The terms of these indemnification arrangements are generally perpetual. Except for losses related to property damages, the maximum potential amount of future payments we could be required to make under these arrangements is unlimited. As of December 31, 2010, we have not incurred any significant costs since the spin-offs of Varian, Inc. and Varian Semiconductor Equipment Associates, Inc. to defend lawsuits or settle claims related to these indemnification arrangements. As a result, we believe the estimated fair value of these arrangements is minimal.

We have entered into indemnification agreements with our directors and officers and certain of our employees that serve as officers or directors of our foreign subsidiaries that may require us to indemnify our directors and officers and those certain employees against liabilities that may arise by reason of their status or service as directors or officers, and to advance their expenses incurred as a result of any legal proceeding against them as to which they could be indemnified.

Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued the consolidation guidance for variable-interest entities to replace the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable-interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable-interest entity that most significantly impact the entity s economic performance. The new guidance was effective for us in the first quarter of fiscal year 2011. The adoption of the new guidance did not have a material impact on our existing consolidated financial position, results of operations or cash flows.

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In March 2010, the FASB issued the guidance related to the Milestone Method of Revenue Recognition (ASU 2010-17), which recognizes the milestone method as an acceptable revenue recognition method for substantive milestones in research or development transaction. ASU 2010-17 was effective for us in the first quarter of fiscal year 2011. The adoption of the new guidance did not have a material impact on our consolidated financial position, results of operations or cash flows.

In July 2010, the FASB issued ASU 2010-20 to provide guidance to enhance disclosures related to the credit quality of a company s financing receivables portfolio and the associated allowance for credit losses. Pursuant to this guidance, a company is required to provide a greater level of disaggregated information about its allowance for credit loss with the objective of facilitating users evaluation of the nature of credit risk inherent in the company s portfolio of financing receivables, how that risk is analyzed and assessed in arriving at the allowance for credit losses, and the changes and reasons for those changes in the allowance for credit losses. The adoption of this new guidance related to the revised disclosures as of the end of the reporting period in the first quarter of fiscal year 2011 did not have any material impact on our consolidated financial position, results of operations and cash flows. The revised disclosures related to activities during the reporting period will be effective for us beginning in the second quarter of fiscal year 2011 and it is not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Credit Risk

We are exposed to credit loss in the event of nonperformance by counterparties on the foreign currency forward contracts used in hedging activities. These counterparties are large international and regional financial institutions and to date, no such counterparty has failed to meet its financial obligation to us under such contracts. In addition, cash and cash equivalents held with financial institutions may exceed the Federal Deposit Insurance Corporation insurance limits or similar limits in foreign jurisdictions. We also may need to rely on the credit facility described below under Interest Rate . Our access to our cash and cash equivalents or ability to borrow could be reduced if one or more financial institutions with which we have deposits or from which we borrow should fail or otherwise be adversely impacted by conditions in the financial or credit markets. Conditions such as those we experienced as a result of the economic downturn and accompanying contraction in the credit markets heighten these risks.

Foreign Currency Exchange Rate Risk

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

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

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

The notional values of our sold and purchased foreign currency forward contracts outstanding as of December 31, 2010 were $285.1 million and $55.9 million, respectively. The notional amounts of forward contracts are not a measure of our exposure. The fair value of forward contracts generally reflects the estimated amounts that we would receive or pay to terminate the contracts at the reporting date, thereby taking into account and approximating the current unrealized and realized gains or losses of the open contracts. A move in foreign currency exchange rates would change the fair value of the contracts, and the fair value of the underlying exposures hedged by the contracts would change in a similar offsetting manner.

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Interest Rate Risk

Our market risk exposure to changes in interest rates depends primarily on our investment portfolio and short-term borrowings. Our investment portfolio consisted of cash and cash equivalents as of December 31, 2010. The principal amount of cash and cash equivalents at December 31, 2010 totaled $704 million with a weighted average interest rate of 0.24%.

The Amended BofA Credit Facility (including the Japanese Line of Credit) allows us to borrow up to a maximum amount of $225 million. We collateralized a portion of the Amended BofA Credit Facility with a pledge of 65% of the voting shares that we hold in Varian Medical Systems Nederland B.V., a wholly-owned subsidiary. Borrowings under the Amended BofA Credit Facility (outside of the Japanese Line of Credit) accrue interest based on (a) LIBOR plus a margin, or (b) the federal funds rate plus 0.5% or BofA s prime rate, whichever is greater, minus a margin. Borrowings under the Japanese Line of Credit accrue interest at the basic loan rate announced by the Bank of Japan plus a margin.

We are affected by market risk exposure primarily through the effect of changes in interest rates on amounts payable under the Amended BofA Credit Facility (including the Japanese Line of Credit). As of December 31, 2010, there was no outstanding balance under the Amended BofA Credit Facility. See a detailed discussion of our credit facility under Liquidity and Capital Resources section in Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations.

In addition, we had $23.3 million of long-term debt (including the current maturities of long-term debt) outstanding as of December 31, 2010 that was carried at a weighted average fixed interest rate of 6.9%, with principal payments due in various installments over a four-year period. To date, we have not used derivative financial instruments to hedge the interest rate of our investment portfolio, short-term borrowings or long-term debt, but may consider the use of derivative instruments in the future.

The estimated fair value of our cash and cash equivalents (80% of which was held abroad at December 31, 2010 and could be subject to additional taxation if it were repatriated to the United States) and the estimated fair value of our short-term borrowings under the credit facility approximated the principal amounts reflected above based on the maturities of these financial instruments.

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

Item 4. Controls and Procedures

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

(b) Changes in internal control over financial reporting. There were no changes in our internal control over financial reporting that occurred during the first quarter of fiscal year 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II

OTHER INFORMATION

Item 1. Legal Proceedings

We are subject to various legal proceedings and claims that are discussed in Note 10, Commitments and Contingencies to the Condensed Consolidated Financial Statements, which discussion is incorporated by reference into this item.

Item 1A. Risk Factors

The following risk factors and other information included in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the fiscal year ended October 1, 2010 should be carefully considered. Although the risk factors described below are the ones management deems significant, additional risks and uncertainties not presently known to us or that we presently deem less significant may also impair our business operations. If any of the following risks actually occur, our business, operating results, and financial condition could be adversely affected.

IF OUR PRODUCTS AND PRODUCT LINES FAIL TO CONTINUE TO MEET CUSTOMER DEMANDS, OUR PRODUCTS MAY BECOME LESS USEFUL OR OBSOLETE AND OUR OPERATING RESULTS WILL SUFFER

We believe that IMRT, including VMAT, and IGRT have become accepted standards for treatment in the radiation oncology market. Demand for our IMRT and IGRT products have been historical drivers for our net orders and revenues in Oncology Systems and, because of the significance of Oncology Systems, on our business in general. We recently introduced UNIQUE, a low-energy linear accelerator for more price sensitive markets in international regions, and TrueBeam, a new line of linear accelerators for radiotherapy and radiosurgery, to meet the evolving needs of our IMRT and IGRT customers. We also believe that our RapidArc products for VMAT, are a significant advance in IMRT treatments and can help drive longer term demand for our linear accelerators and IMRT-related products. Orders for these new products and products lines have contributed greatly to our recent orders growth and are keys to our future success. If our customers do not purchase these products or if future studies call into question the effectiveness of these or our other IMRT or IGRT products (including other VMAT products) or show negative side effects, or if other more effective technologies are introduced, our net orders, revenues and financial results could suffer. In addition, if third party information systems do not support our VMAT technology, customers that have third party information systems may not purchase our RapidArc products, which could negatively impact our net orders and revenues. As more institutions buy or upgrade to achieve these capabilities, the market for IMRT and IGRT products (including VMAT products) may become saturated. Alternatively, the marketplace may conclude that functions and features of our products should no longer be an element of a generally accepted diagnostic or treatment regimen. If this occurs, the market for our products may be adversely affected and they may become less useful or obsolete.

Our X-ray Products business sells products primarily to a small number of imaging system OEM customers who use our products in their medical diagnostic and industrial imaging systems. To succeed, we must provide x-ray tube and flat panel detector products that meet customer demands for lower cost, better product quality and superior technology and performance. Flat panel detectors for filmless x-ray imaging have been driving net orders and revenues in the X-ray Products segment, with our newly introduced radiographic panels accountable for a significant part of that expansion. If we are unable to continue to innovate our X-ray Products technology and anticipate our customers demands in the areas of cost, quality, technology and performance, then our customers may purchase from other tube or panel manufacturers (including the in-house operations of some of these customers), which would negatively impact this business.

In both the Oncology Systems and X-ray Products businesses, and in our other product lines, we may be unable to accurately anticipate changes in our markets and the direction of technological innovation and demands of our customers. Our competitors may develop products or processes that are superior to what we can then offer. If this occurs, the market for our products may be adversely affected and they may become less useful or obsolete. Any development adversely affecting the markets for our products would force us to reduce production volumes or to discontinue manufacturing one or more of our products or product lines and would reduce our revenues and earnings.

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OUR SUCCESS DEPENDS ON THE SUCCESSFUL DEVELOPMENT, INTRODUCTION AND COMMERCIALIZATION OF NEW GENERATIONS OF PRODUCTS AND ENHANCEMENTS TO EXISTING PRODUCT LINES

Rapid change and technological innovation characterize the Oncology Systems market. Our products often have long development and government approval cycles, so we must anticipate changes in the marketplace, in technology and in customer demands. Our success depends on the successful development, introduction and commercialization of new generations of products, treatment systems and enhancements to and/or simplification of existing product lines. Our Oncology Systems products, including new products such as TrueBeam and RapidArc, are technologically complex and must keep pace with, if not be superior to, the products of our competitors. Our X-ray Products business must also continually develop improved and lower cost products. We are making significant investments in long-term growth initiatives, such as development of our SIP and Particle Therapy businesses, and expect that we will need more investment to develop and commercialize the products and technology for these businesses. Accordingly, many of our products may require significant planning, design, development and testing, as well as significant capital commitments, involvement of senior management and other investments on our part. We may need to spend more time and money than we expect to develop and introduce new products or enhancements and, even if we succeed, they may not be sufficiently profitable that we are able to recover all or a meaningful part of our investment. Once introduced, new products may adversely impact orders and sales of our existing products, or make them less desirable or even obsolete, and could adversely impact our revenues and operating results. Compliance with regulations, competitive alternatives, and shifting market preferences may also impact our success with new products or enhancements.

Our ability to successfully develop and introduce new products 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 the feasibility of new products;
- limit the time required from proof of feasibility to routine production;
- comply with internal quality assurance systems and processes timely and efficiently;
- limit the timing and cost of regulatory approvals;
- accurately predict and control costs associated with inventory overruns caused by phase-in of new products and phase-out of old products;
- price our products competitively and profitably;
- manufacture, deliver and install our products in sufficient volumes on time, and accurately predict and control costs associated with manufacturing, installation, warranty and maintenance of the products;
- appropriately manage our supply chain;
- manage customer acceptance and payment for products;

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

anticipate and compete successfully with competitors.

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

New products generally take longer to install than well-established products. Because a portion of a product s revenue is generally tied to installation and acceptance of the product, our recognition of revenue associated with new products may be deferred longer than expected. In addition, even if we succeed in our product introductions, potential customers may not decide to upgrade their equipment, or customers may delay delivery of some of our more sophisticated products because of the longer preparation and renovation of treatment rooms required. As a result, our revenues and other financial results could be adversely affected.

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

We conduct business globally. Our international revenues accounted for approximately 62% and 58% of revenues from continuing operations during the first quarter of fiscal years 2011 and 2010, respectively. As a result, we must provide significant service and support globally. We intend to continue to expand our presence in international markets and expect to expend significant resources in doing so, although we cannot be sure we will be able to meet our sales, service and support objectives or obligations, or recover our investments. Accordingly, our future results could be harmed by a variety of factors, including:

- the difficulties in enforcing agreements and collecting receivables through many foreign country s legal systems;
- the longer payment cycles associated with many foreign customers;
- the imposition by foreign countries of additional taxes, tariffs or other restrictions on foreign trade;
- the lower sales prices and gross margins usually associated with sales of our products in international regions;
- the longer period from shipment to revenue recognition that generally results in greater revenue recognition deferrals and higher backlog;
- any inability to obtain export licenses and other required export or import licenses or approvals;
- failure to comply with export laws and requirements which may result in civil or criminal penalties and restrictions on our ability to export our products, particularly our industrial linear accelerator products;
- failure to obtain proper business licenses or other documentation, or to otherwise comply with local laws and requirements regarding marketing, sales, service or any other business we conduct in a foreign jurisdiction, which may result in civil or criminal penalties and restrictions on our ability to conduct business in a foreign jurisdiction;
- changes in the political, regulatory, safety or economic conditions in a country or region; and
- the possibility that it may be more difficult to protect our intellectual property in foreign countries.

Although our orders and sales fluctuate from period to period, in recent years our international region has represented a larger share of our business. The more we depend on sales in the international region, the more vulnerable we become to these factors.

As of December 31, 2010, 80% of our cash and cash equivalents were held abroad. If these funds were repatriated to the United States, they could be subject to additional taxation and our overall tax rate and our results of operations could suffer.

Our effective tax rate is impacted by tax laws in both the United States and in the respective countries in which our international subsidiaries do business. Earnings from our international region are generally taxed at rates lower than U.S. rates. A change in the percentage of our total earnings from international region, or a change in the mix of particular tax jurisdictions within the international region could cause our effective

tax rate to increase or decrease. Also, we are not currently taxed in the United States on certain undistributed earnings of certain foreign subsidiaries. These earnings could become subject to incremental foreign withholding or U.S. federal and state taxes should they either be deemed or actually remitted to the United States, or if tax laws change, in which case our financial results could be adversely affected. In addition, Congress has recently considered proposals that would significantly change U.S. taxation of U.S.-based multinational corporations. Although we cannot predict whether or in what form Congress would enact any such proposals, legislation of this type could negatively impact our effective tax rate and adversely affect our financial results.

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OUR RESULTS HAVE BEEN AND MAY CONTINUE TO BE AFFECTED BY THE WORLDWIDE ECONOMIC DOWNTURN

Since fiscal year 2008, the global economy has been impacted by the sequential effects of the subprime lending crisis; the credit market crisis; collateral effects on the finance and banking industries; volatile currency exchange rates and energy costs; concerns about inflation (deflation), slower economic activity, consumer confidence, corporate profits and capital spending, adverse business conditions, liquidity and unemployment. These conditions have shrunk capital equipment budgets, slowed decision-making, made financing for large equipment purchases more expensive and more time consuming to obtain, and made it difficult for our customers and our vendors to accurately forecast and plan future business activities. This, in turn, caused our customers to freeze or dramatically reduce purchases and capital project expenditures. Even with economic recovery, it has taken time for our customers to establish new budgets and may take more time for them to fully return to normal purchasing patterns. These conditions may also disrupt supply if vendors consolidate or go out of business. As with our customers and vendors, such conditions make it more difficult for us to accurately forecast and plan our future business activities. While we have seen some improvement, we cannot predict the strength or sustainability of an economic recovery, in general or specifically in the healthcare industry. Historically, our business has felt the effects of market trends later than other sectors in the healthcare industry, such as diagnostic radiology, and we may experience the effects of any economic recovery later than others in the healthcare industry. A continued weak or deteriorating healthcare market would inevitably adversely affect our business, financial conditions and results of operations. Also, while the economic downturn has primarily affected our business in North America, other economic turmoil, such as the banking and currency instability in certain European countries, may negatively affect our international business.

In addition, some countries, including Japan, have adopted government stimulus programs to revitalize their economies and improve healthcare and medical services. The adoption of these stimulus programs could positively affect our results in one period and adversely affect our results in other periods, making it difficult for investors to compare our financial results between fiscal periods.

THE AFFORDABLE HEALTHCARE FOR AMERICA ACT INCLUDES PROVISIONS THAT MAY ADVERSELY AFFECT OUR BUSINESS AND RESULTS OF OPERATIONS, INCLUDING AN EXCISE TAX ON THE SALES OF MOST MEDICAL DEVICES

On March 23, 2010, President Obama signed into law the Affordable Health Care for America Act. While we are continuing to evaluate this legislation and its potential impact on our business, it may adversely affect the demand for our products and services, and therefore our financial position and results of operations, possibly materially.

Specifically, one of the components of the new law is a 2.3% excise tax on sales of most medical devices, which include our Oncology Systems products, starting in 2013. The Congressional Budget Office estimates that the total cost to the medical device industry could exceed $20 billion over ten years. This tax may put increased pressure on medical device manufacturers and purchasers, and may lead our customers to reduce their orders for products we produce or to request that we reduce the prices we charge for our products in order to off-set the tax. Other elements of this new legislation, including comparative effectiveness research, an independent payment advisory board, payment system reforms (including shared savings pilots) and other provisions, could meaningfully change the way healthcare is developed and delivered, and may materially impact numerous aspects of our business, including the demand and availability of our products, the reimbursement available for our products from governmental and third-party payors, and reduced medical procedure volumes.

Various healthcare reform proposals have also emerged at the state level, and we are unable to predict which, if any of these proposals will be enacted. We believe that the uncertainty created by healthcare reform in the United States has complicated our customers decision-making process and impacted our Oncology Systems business, and we expect that this uncertainty will persist until there is greater clarity on how the Affordable Health Care for America Act and state proposals will affect healthcare providers. We are unable to predict what effect ongoing uncertainty surrounding these matters will have on our customer s purchasing decisions. However, an expansion in government s role in the U.S. healthcare industry may adversely affect our business, possibly materially.

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CHANGES TO RADIATION ONCOLOGY REIMBURSEMENTS MAY AFFECT DEMAND FOR OUR PRODUCTS

Sales of our healthcare products indirectly depend on whether adequate reimbursement is available to our customers from a variety of sources, such as government healthcare insurance programs, including the Medicare and Medicaid programs; private insurance plans; health maintenance organizations; and preferred provider organizations. In general, third-party payors in the United States are increasingly cost-conscious, and we cannot be sure that they will reimburse our customers at levels sufficient to enable us to achieve or maintain sales and price levels for our products in this market. Without adequate support from third-party payors, the market for our products may be limited. There is no uniform policy on reimbursement among third-party payors, nor can we be sure that procedures using our products will qualify for reimbursement from third-party payors. Once Medicare has made a decision to provide reimbursement for a given treatment, these reimbursement rates are generally reviewed and adjusted by Medicare annually. Private third-party payors, although independent from Medicare, sometimes use portions of Medicare reimbursement policies and payment amounts in making their own reimbursement decisions. As a result, decisions by the U.S. Centers for Medicare and Medicaid Services (CMS) to reimburse for a treatment, or changes to Medicare s reimbursement policies or reductions in payment amounts with respect to a treatment sometimes extend to third-party payor reimbursement policies and amounts for that treatment. We have seen our customers decision-making process complicated by the uncertainty surrounding Medicare reimbursement rates for radiotherapy and radiosurgery in the United States. From time to time, CMS and third party payors may review and modify the factors upon which they rely to determine appropriate levels of reimbursement for cancer treatments. For example, CMS and third-party payors have begun to focus on the comparative effectiveness of radiation therapy versus other methods of cancer treatment, and could modify reimbursement rates based on the results of comparative effectiveness studies. If comparative effectiveness studies are not available, or if available studies show that other cancer treatments are more effective than radiotherapy or radiosurgery, reimbursement rates for radiotherapy or radiosurgery could be reduced. Any significant cuts in reimbursement rates for radiotherapy, radiosurgery, proton therapy or brachytherapy, or concerns or proposals regarding further cuts, could further increase uncertainty, influence our customers decisions, reduce demand for our products, cause customers to cancel orders and have a material adverse effect on our revenues and stock price.

Foreign governments also have their own healthcare reimbursement systems and we cannot be sure that adequate reimbursement will be made available with respect to our products under any foreign reimbursement system.

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

Because our business is global and payments are generally made in local currency, fluctuations in foreign currency exchange rates can impact our results by affecting product demand or our expenses and/or the profitability in U.S. dollars of products and services that we provide in foreign markets.

While we use hedging strategies to help offset the effect of fluctuations in foreign currency exchange rates, the protection these strategies provide is affected by the timing of transactions, and the effectiveness of those strategies, the number of transactions that are hedged, forecast volatility and the extent to which exchange rates have changed. If our hedging strategies do not offset these fluctuations, our revenues and other operating results may be harmed. In addition, movement in foreign currency exchange rates could impact our financial results positively or negatively in one period and not another, making it more difficult to compare our financial results from period to period. Furthermore, on July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). The Dodd-Frank Act contains provisions which may impact our existing hedging strategies, but we cannot predict those effects at this time.

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

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

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

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

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

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

Within the EEA, we must affix a CE mark, a European marking of conformity that indicates that a product meets the relevant regulatory requirements and, when used as intended, works properly and is acceptably safe. This conformity to the applicable directives is done through self-declaration and may be verified by an independent certification body, called a Notified Body. Once clearance is obtained and the CE mark is affixed to the device, the Notified Body will regularly audit us to ensure that we remain in compliance with the applicable European laws or directives. CE marking demonstrates that our products comply with the laws and regulations required by the EEA countries to allow free movement of trade within the EEA countries. If we cannot support our performance claims and demonstrate compliance with the applicable European laws and directives, we lose our CE mark, which would prevent us from selling our products within the EEA. Significant revisions to some of the applicable regulations governing requirements for medical devices in the EEA went into effect in March 2010. These revisions have introduced additional uncertainty into the marketing authorization process for medical devices in Europe. Until medical device manufacturers and European regulatory agencies, including Notified Bodies and competent authorities, have greater experience with interpreting and applying the revised regulations, we may be subject to risks associated with additional testing, modification, certification or amendment of our existing market authorizations, or we may be required to modify installed products in order to comply with the official interpretations of these revised regulations.

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

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

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

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

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

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

- adverse publicity affecting both us and our customers;
- increased pressures from our competitors;
- investigations by governmental authorities or Warning Letters;

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fines, injunctions, and civil penalties;

partial suspensions or total shutdown of production facilities, or the imposition of operating restrictions;

increased difficulty in obtaining required FDA clearances or approvals, or the equivalent approvals in foreign countries;

losses of clearances or approvals already granted;

seizures or recalls of our products or those of our customers;

delays in purchasing decisions by customers or cancellation of existing orders;

the inability to sell our products, or, where we have failed to comply with foreign regulations, to import our products to such countries;

difficulty in obtaining product liability or operating insurance at a reasonable cost, or at all; and

criminal prosecutions.

Other applicable regulations. As a participant in the healthcare industry, we are also subject to extensive laws and regulations protecting the privacy and integrity of patient medical information, including the Health Insurance Portability and Accountability Act of 1996 (HIPAA) and similar laws and regulations in foreign countries covering data privacy and other protection of health and employee information, fraud and abuse laws and regulations, including physician self-referral prohibitions, anti-kickback laws and false claims laws. From time to time, these laws and regulations may be revised or interpreted in ways that could make it more difficult for our customers to conduct their businesses, such as recent proposed revisions to the laws prohibiting physician self-referrals, and such revisions could have an adverse effect on the demand for our products, and therefore our business and results of operations. We also must comply with numerous federal, state and local laws of more general applicability relating to such matters as safe working conditions, manufacturing practices and fire hazard control.

The laws and regulations and their enforcement are constantly undergoing change, and we cannot predict what effect, if any, changes to these laws and regulations may have on our business. For example, HIPAA was recently amended by the Health Information Technology for Economic and Clinical Health Act (the HITECH Act), enacted as part of the American Recovery and Reinvestment Act of 2009. The HITECH Act significantly increases the civil money penalties for violations of patient privacy rights protected under HIPAA. Furthermore, business associates who have access to patient health information provided by hospitals and healthcare providers are now directly subject to HIPAA, including the new enforcement scheme and inspection requirements. Moreover, there has been a trend in recent years, both in the United States and internationally, toward more stringent regulation and enforcement of requirements applicable to medical device manufacturers and requirements regarding protection and confidentiality of personal data.

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

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

Regulatory requirements affecting our operations and sales outside the United States vary from country to country, often differing significantly from those in the United States. In general, outside the United States, our products are regulated as medical devices by foreign governmental

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

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

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

Federal and state false claims laws generally prohibit knowingly presenting, or causing to be presented, claims for payment from Medicare, Medicaid or other third-party payors that are false or fraudulent, or for items or services that were not provided as claimed. Although we do not submit claims directly to payors, manufacturers can be held liable under these laws if they are deemed to cause the submission of false or fraudulent claims by providing inaccurate billing or coding information to customers, or through certain other activities, including promoting products for uses not approved or cleared by the FDA, which is called off-label promotion. Violating anti-kickback and false claims laws can result in civil and criminal penalties, which can be substantial, and potential exclusion from healthcare programs for noncompliance. Even an unsuccessful challenge or investigation into our practices could cause adverse publicity, and be costly to defend, and thus could harm our business and results of operations. Additionally, several recently enacted state and federal laws, including the laws in Massachusetts and Vermont, and the federal Physician Payment Sunshine Act, now require, among other things, extensive tracking, maintenance of data bases regarding and disclosures of relationships and payments to physicians and healthcare providers. These laws require us to implement the necessary and costly infrastructure to track and report certain payments to healthcare providers. Failure to comply with these new tracking and reporting laws could subject us to significant civil monetary penalties.

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

We are also subject to the U.S. Foreign Corrupt Practices Act, antitrust and anti-competition laws, and similar laws in foreign countries, such as the U.K. Bribery Act of 2010. Any violation of these laws could create a substantial liability for us, subject our officers and directors to personal liability and also cause a loss of reputation in the market. As we expand our business internationally, we will inevitably do more business in countries where the public sector is perceived to be subject to more corruption. Transparency International s 2010 Corruption Perceptions Index measured the degree to which public sector corruption is perceived to exist in 178 countries around the world, and found that nearly three quarters of the countries in the index, including many that we consider to be high growth areas, such as China, India, Russia and Brazil, scored below five, on a scale from 10 (very clean) to 0 (highly corrupt). Increased business in higher risk countries could subject us and our officers and directors to increased scrutiny and increased liability. From time to time, we may conduct internal investigations or face audits or investigations by one or more domestic or foreign government agencies, which could be costly and time-consuming, and could divert our management and key personnel from our business operations. An adverse outcome under any such investigation or audit could subject us to fines or criminal or other penalties, which could adversely affect our business and financial results.

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

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

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

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

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

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

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

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In x-ray imaging components and subsystems, we often compete with companies that have greater financial, marketing and other resources than we have. Some of the major diagnostic imaging systems companies, which are the primary OEM customers for our x-ray components, also manufacture x-ray components, including x-ray tubes, for use in their own imaging systems products. We must compete with these in-house manufacturing operations for business from their affiliated companies. In addition, we compete against other stand-alone, independent x-ray tube manufacturers who compete with us for both the OEM business of major diagnostic imaging equipment manufacturers and the independent servicing business for x-ray tubes. The market for flat panel detectors is also very competitive. As a result, we must have a competitive advantage in one or more significant areas, which may include lower product cost, better product quality and/or superior technology and/or performance.

In our SIP business, we compete with other OEM suppliers, primarily outside of the United States. The market for our SIP products used for nondestructive testing in industrial applications is small and highly fractured.

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

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

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

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

Obtaining and maintaining this interoperability and compatibility can be costly and time-consuming. While we try to use standard published protocols for communication with other widely used radiation oncology products manufactured by other companies, if this cannot be done, we may need to develop individual interfaces so that our products communicate correctly. When other companies modify the design or functionality of their products, this may affect their compatibility with our

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

PROTECTING OUR INTELLECTUAL PROPERTY CAN BE COSTLY AND WE MAY NOT BE ABLE TO MAINTAIN LICENSED RIGHTS, AND IN EITHER CASE OUR COMPETITIVE POSITION WOULD BE HARMED IF WE ARE NOT ABLE TO DO SO

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

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

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

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

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

We obtain some of the components included in our products from a limited group of suppliers or from a single-source supplier, such as the radioactive sources for high dose afterloaders, klystrons for linear accelerators, transistor arrays and cesium iodide coatings for flat panel detectors, and specialized integrated circuits, x-ray tube targets, housings, glassframes and various other x-ray tube components. If we lose any of these suppliers or if their operations were substantially interrupted, we would be required to obtain and qualify one or more replacement suppliers, which may then also require us to redesign or modify our products to incorporate new parts and/or further require us to obtain clearance, qualification or certification of such product by the FDA or other applicable regulatory approvals in other countries. Events like these could significantly increase costs for the affected product and likely cause material delays in delivery of that and other related products. Although we have insurance to protect against business interruption loss, this insurance coverage may not be adequate or continue to remain available on acceptable terms, if at all. Additionally, some of our suppliers, including some of our single-source suppliers, supply components for certain of our rapidly growing product lines. Manufacturing capacity limitations of any of these suppliers or other inability of these suppliers to meet increasing demand could adversely affect us, resulting in curtailed growth opportunities for any of our product lines. Shortage of, and greater demand for, components and subassemblies could also increase manufacturing costs by increasing prices. Disruptions or loss of any of our limited- or sole-source components or subassemblies or the capacity limitations of the suppliers for these components or subassemblies, including the ones referenced above, could adversely affect our business and financial results and could damage our customer relationships.

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

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

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

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

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

There has been a consolidation of diagnostic imaging systems manufacturers over the past few years, including the consolidation of these customers into companies that already manufacture x-ray tubes. If this continues, we could experience less predictable and reduced sales of our x-ray tube products. In addition, the economic downturn has made it difficult for our OEM customers to accurately forecast and plan future business activities, and we saw our x-ray business impacted in fiscal year 2009 by inventory reduction efforts at some of these customers. Our agreements for x-ray components may contain purchasing estimates that are based on our customers historical purchasing patterns, and actual purchasing volumes under the agreements may vary significantly from our estimates. In recent years, we have also seen dramatic reductions in

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Medicare reimbursements for diagnostic radiology. We believe reductions in these Medicare reimbursement rates have reduced demand for medical x-ray imaging equipment, such as CT scanners, which have negatively impacted demand for our x-ray tube products. Also, because we sell our x-ray products to a limited number of OEM customers and many of them are also our competitors with in-house x-ray tube manufacturing operations, we could experience the loss of, or reduction in purchasing volume by, one or more of these customers if they lower external sourcing costs. Such a loss or reduction could have a material adverse effect on our X-ray Products business.

ORDERS FOR OUR SECURITY AND INSPECTION PRODUCTS COULD BE UNPREDICTABLE

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

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

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

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

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

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

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

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

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

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

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

Further, we may find that we need to restructure or divest acquired businesses, or assets of those businesses. Even if we do so, an acquisition may not produce the full efficiencies, growth or benefits we expected. If we decide to sell assets or a business, as we did in fiscal year 2008 with Research Instruments, it may be difficult to identify buyers or alternative exit strategies on acceptable terms, in a timely manner, or at all, which could delay the accomplishment of our strategic objectives, or we may dispose of a business at a lower price or on less advantageous terms than we had anticipated.

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

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

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

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

In the second quarter of fiscal year 2009, we completed the sale of Research Instruments. We retained the responsibility for one contract as of the end of fiscal year 2010. We have incurred, and may continue to incur, additional costs beyond those expected with the remaining contract which could adversely affect our financial condition. Continued efforts related to managing the remaining contract have required, and may likely continue to require, a substantial amount of management, administrative, financial and operational resources, particularly as unanticipated difficulties with the fulfillment of this contract are encountered. These demands may distract our employees and management from the day-to-day operation of our other businesses. If we are not able to successfully resolve these residual retained responsibilities in a timely manner, we may be subject of lawsuits, financial penalties and costs and further management, administrative and operational distraction, all of which may adversely affect our business, results of operations and financial condition.

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

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

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

We have experienced and expect in the future to experience fluctuations in our operating results, including net orders, revenues and margins. Drivers of orders include timing of announcement of and introduction of new products or product enhancements by us and our competitors, as well as changes or anticipated changes in third party reimbursement amounts or policies applicable to treatments using our products. The availability of economic stimulus packages or other government funding may also affect timing of customer purchases. Many of our products require significant capital expenditures by our customers. Accordingly, individual product orders can be quite large in dollar amounts, which can extend the customer purchasing cycle. We have experienced this with our IGRT products, and expect this to be even greater with our proton therapy products because of the high cost of the equipment and the complexity of project financing. In addition, the budgeting cycles of hospitals and clinics for capital equipment purchases are frequently fixed well in advance. As a result of the recent worldwide economic downturn and contraction in credit markets, as well as the uncertainty surrounding the impact of healthcare reform and changes to reimbursement rates, the purchasing cycle has extended and may extend even further as potential customers more closely scrutinize and prioritize their capital spending budgets, and analyze appropriate financing alternatives. In addition, some of our more sophisticated equipment, such as IGRT and proton therapy products, requires greater site preparation and longer construction cycles, which can delay customer decision cycles even further. The timing of when individual orders are placed, installation is accomplished and the revenues recognized affect our quarterly results.

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

- delay in shipment due, for example, to unanticipated construction delays at customer locations where our products are to be installed, cancellations or rescheduling by customers, extreme weather conditions, natural disasters or port strikes;
- delay in the installation and/or acceptance of a product;
- for proton therapy systems, failure to satisfy contingencies associated with an order;
- the method of accounting used to recognize revenue;
- timing of revenue recognition;

a change in a customer s financial condition or ability to obtain financing; or

timing of appropriate regulatory approvals or authorizations.

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

- changes in our or our competitors pricing or discount levels;
- changes in foreign currency exchange rates;
- changes in the relative portion of our revenues represented by our various products, including the relative mix between higher margin and lower margin products;
- changes in the relative portion of our revenues represented by the international regions;
- fluctuation in our effective tax rate, which may or may not be known to us in advance;
- disruptions in the supply or changes in the costs of raw materials, labor, product components or transportation services;
- disruptions in our operations, including our ability to manufacture products, caused by events such as earthquakes, fires, floods, terrorist attacks or the outbreak of epidemic diseases;
- changes in the general economic conditions or tightening of credit available to our customers;
- the impact of changing levels of sales on sole purchasers of certain of our x-ray products;
- the unfavorable outcome of any litigation or administrative proceeding or inquiry; and
- accounting changes and adoption of new accounting pronouncements.

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

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

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

The acquisition of the business we now call Varian Particle Therapy should enable us to develop and offer products for delivering image-guided, intensity-modulated proton therapy for the treatment of cancer. Our success in this area will depend upon the wide-spread awareness, acceptance and adoption by the oncology market of proton therapy systems for the treatment of cancer. However, this technology may not be accepted as quickly as others.

Since proton therapy projects are highly customized and are generally large and more complex, planning for these projects will take more time and use more resources than those in the radiotherapy business conducted in our Oncology Systems segment. Due to its relatively large scale, the construction of a proton therapy facility requires significant capital investment and may involve complex project financing. The worldwide economic downturn resulted in a contraction in credit markets. To the extent this persists, it may make it more difficult for potential customers of this business to find appropriate financing for large proton therapy projects, which could cause them to delay or cancel their projects, or request our participation in financing arrangements or payment concessions in their agreements with us, which could impact our operating results. In addition, due to their size and complexity, the sales and customer decision cycles for proton therapy projects may take several years. As a result, the timing of these projects, and therefore our operating results for this business, may vary significantly from period to period.

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

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

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

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

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

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

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

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

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

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

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

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

We offer longer or extended payment terms for qualified customers in some circumstances. Many of the areas where we offer such longer or extended payment terms have under-developed legal systems for securing debt and enforcing collection of debt. As of December 31, 2010, customer contracts with remaining terms of more than one year amounted to less than 1% of our accounts receivable balance. While we qualify customers to whom we offer longer or extended payment terms, their financial positions may change adversely over the longer time period given for payment. This may result in an increase in payment defaults and uncollectible accounts, which would affect our net earnings. In addition, longer or extended payment terms could impact the timing of our revenue recognition, and they have in the past and may in the future result in an increase in our days sales outstanding.

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

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

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

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

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

(a) Not applicable

(b) Not applicable

(c) The following table provides information with respect to the shares of common stock repurchased by us during the first quarter of fiscal year 2011.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)
October 2, 2010 - October 29, 2010		$		4,461,751
October 30, 2010 - November 26, 2010	1,244(2)	$ 63.37		4,461,751
November 27, 2010 - December 31, 2010		$		4,461,751
Total	1,244	$		

(1) On August 6, 2010, VMS s Board of Directors authorized the repurchase of 8,000,000 shares of VMS common stock from August 7, 2010 through September 30, 2011. We expect remaining repurchases under this authorization, if any, will be made in open market purchases, in privately negotiated transactions or under Rule 10b5-1 share repurchase plans, and may be made from time to time or in one or more large blocks, including accelerated share repurchase arrangements. Shares will be retired upon repurchase.

(2) Consists of 1,244 shares of VMS common stock that were tendered to VMS in satisfaction of tax withholding obligations upon the vesting of restricted common stock granted under the Company s employee stock plans.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Reserved

Item 5. Other Information

None.

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Item 6. Exhibits

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

Exhibit No.	Description
3.2	Registrant s By-Laws, as amended, effective November 12, 2010 (incorporated by reference to Exhibit No. 3.2 to the Registrant s Form 8-K/A Current Report filed as of November 17, 2010, File No. 1-7598).
15.1	Letter Regarding Unaudited Interim Financial Information.
31.1	Chief Executive Officer Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act.
31.2	Chief Financial Officer Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act.
32.1	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Attached as Exhibit 101 to this Quarterly Report on Form 10-Q are the following formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Statements of Earnings for the three months ended December 31, 2010 and January 1, 2010; (ii) Condensed Consolidated Statements of Earnings for the three months ended December 31, 2010 and January 1, 2010; (iii) Condensed Consolidated Balance Sheets at December 31, 2010 and October 1, 2010; (iv) Condensed Consolidated Statements of Cash Flows for the three months ended December 31, 2010 and January 1, 2010; and (v) Notes to Condensed Consolidated Financial Statements for the three months ended December 31, 2010.

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

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

VARIAN MEDICAL SYSTEMS, INC.
(Registrant)

Dated: February 9, 2011

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

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101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Attached as Exhibit 101 to this Quarterly Report on Form 10-Q are the following formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Statements of Earnings for the three months ended December 31, 2010 and January 1, 2010; (ii) Condensed Consolidated Statements of Earnings for the three months ended December 31, 2010 and January 1, 2010; (iii) Condensed Consolidated Balance Sheets at December 31, 2010 and October 1, 2010; (iv) Condensed Consolidated Statements of Cash Flows for the three months ended December 31, 2010 and January 1, 2010; and (v) Notes to Condensed Consolidated Financial Statements for the three months ended December 31, 2010.

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