VARIAN MEDICAL SYSTEMS INC
Form 10-Q
May 07, 2007
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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 March 30, 2007

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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: 127,469,414 shares of common stock, par value $1 per share, outstanding as of April 27, 2007.

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VARIAN MEDICAL SYSTEMS, INC.

FORM 10-Q for the Quarter Ended March 30, 2007

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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		Six Months Ended	
(In thousands, except per share amounts)	**March 30, 2007**	**March 31, 2006**	**March 30, 2007**	**March 31, 2006**
Revenues:				
Product	$ 359,359	$ 351,721	$ 677,182	$ 626,694
Service contracts and other	83,323	62,137	153,358	121,395
Total revenues	442,682	413,858	830,540	748,089
Cost of revenues:				
Product	207,542	206,337	398,475	368,082
Service contracts and other	49,971	36,436	86,746	70,158
Total cost of revenues	257,513	242,773	485,221	438,240
Gross margin	185,169	171,085	345,319	309,849
Operating expenses:				
Research and development	28,460	25,012	55,426	47,229
Selling, general and administrative	70,261	66,549	133,403	123,332
Total operating expenses	98,721	91,561	188,829	170,561
Operating earnings	86,448	79,524	156,490	139,288
Interest income	3,385	3,633	6,873	6,383
Interest expense	(1,363)	(1,099)	(2,405)	(2,183)
Earnings from operations before taxes	88,470	82,058	160,958	143,488
Taxes on earnings	27,519	26,260	50,506	46,530
Net earnings	$ 60,951	$ 55,798	$ 110,452	$ 96,958
Net earnings per share - Basic	$ 0.48	$ 0.42	$ 0.86	$ 0.74
Net earnings per share - Diluted	$ 0.46	$ 0.41	$ 0.83	$ 0.71
Weighted average shares used in the calculation of:				
Net earnings per share - Basic	128,205	131,926	128,689	131,492
Net earnings per share - Diluted	131,868	136,821	132,509	136,368

See accompanying notes to the consolidated financial statements.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except par values)	March 30, 2007	September 29, 2006 (1)
Assets		
Current assets:		
Cash and cash equivalents	$ 288,778	$ 272,508
Short-term marketable securities		93,599
Accounts receivable, net of allowance for doubtful accounts of $4,164 at March 30, 2007 and $4,473 at September 29, 2006	421,391	471,820
Inventories	267,683	189,653
Prepaid expenses and other current assets	34,326	25,953
Deferred tax assets	102,176	102,516
Total current assets	1,114,354	1,156,049
Property, plant and equipment, net	147,263	130,318
Goodwill	153,955	121,389
Other assets	125,750	103,995
Total assets	$ 1,541,322	$ 1,511,751
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 78,287	$ 77,985
Accrued expenses	256,044	265,750
Deferred revenues	92,626	117,813
Current maturities of long-term debt	7,962	7,954
Product warranty	47,518	42,992
Advance payments from customers	162,470	131,462
Total current liabilities	644,907	643,956
Long-term debt	55,916	49,356
Other long-term liabilities	25,709	21,186
Total liabilities	726,532	714,498
Commitments and contingencies (Note 8)		
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; 127,887 and 129,721 shares issued and outstanding at March 30, 2007 and at September 29, 2006, respectively	127,887	129,721
Capital in excess of par value	297,179	265,214
Retained earnings	394,255	406,849
Accumulated other comprehensive loss	(4,531)	(4,531)
Total stockholders equity	814,790	797,253
Total liabilities and stockholders equity	$ 1,541,322	$ 1,511,751

(1) The condensed consolidated balance sheet as of September 29, 2006 was derived from audited financial statements as of that date, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

See accompanying notes to the consolidated financial statements.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)	Six Months Ended March 30, 2007	March 31, 2006
Cash flows from operating activities:		
Net earnings	$ 110,452	$ 96,958
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Share-based compensation expense	23,013	19,876
Tax benefits from exercises of share-based payment awards	13,430	46,061
Excess tax benefits from share-based compensation	(12,513)	(43,455)
Depreciation	12,532	11,773
Provision for doubtful accounts receivable	111	233
Loss (gain) on disposal of property, plant and equipment	55	(13)
Amortization of intangible assets	2,548	2,928
Amortization of premium/discount on marketable securities, net	29	80
Deferred taxes	(5,842)	(6,064)
Net change in fair value of derivatives and underlying commitments	(1,858)	3,877
Income on equity investment in affiliate	(28)	(1,357)
Other		72
Changes in assets and liabilities:		
Accounts receivable	75,532	(25,254)
Inventories	(60,458)	(10,705)
Prepaid expenses and other current assets	(4,129)	(7,165)
Accounts payable	(7,408)	(114)
Accrued expenses	(13,785)	(33,871)
Deferred revenues	(25,187)	4,182
Product warranty	3,880	74
Advance payments from customers	13,542	13,008
Other long-term liabilities	523	(579)
Net cash provided by operating activities	124,439	70,545
Cash flows from investing activities:		
Proceeds from maturities or sale of marketable securities	193,470	46,665
Purchases of marketable securities	(99,900)	(35,000)
Acquisition of business, net of cash acquired	(26,792)	
Purchases of property, plant and equipment	(25,387)	(17,371)
Equity investment in affiliate	(10,915)	(2,980)
Increase in cash surrender value of life insurance	(4,155)	(3,541)
Note receivable from affiliate and other	616	(151)
Proceeds from disposal of property, plant and equipment	656	340
Other, net	(1,932)	(90)
Net cash provided by (used in) investing activities	25,661	(12,128)
Cash flows from financing activities:		
Repurchases of common stock	(152,911)	(123,836)
Proceeds from issuance of common stock to employees	23,590	52,639
Excess tax benefits from share-based compensation	12,513	43,455
Employees taxes withheld and paid for restricted performance shares and restricted stock	(63)	(8,077)

Repayment of mandatorily redeemable financial instrument	(11,771)	
Repayments of bank borrowings	(100)	(100)
Net cash used in financing activities	(128,742)	(35,919)
Effects of exchange rate changes on cash and cash equivalents	(5,088)	681
Net increase in cash and cash equivalents	16,270	23,179
Cash and cash equivalents at beginning of period	272,508	243,086
Cash and cash equivalents at end of period	$ 288,778	$ 266,265

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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 advanced equipment and software products for treating cancer with radiation. The Company also designs, manufactures, sells and services high quality, cost-effective X-ray tubes for original equipment manufacturers; replacement X-ray tubes; flat panel digital image detectors for filmless X-rays (commonly referred to as flat panel detectors or digital image detectors) for medical, scientific and industrial applications; linear accelerators for security and inspection purposes; and proton therapy systems for cancer treatment and scientific instruments used in particle research.

Fiscal Year

The Company s fiscal year is the 52- or 53-week period ending on the Friday nearest September 30. Fiscal year 2007 is the 52-week period ending September 28, 2007, and fiscal year 2006 was the 52-week period ended September 29, 2006. The fiscal quarters ended March 30, 2007 and March 31, 2006 were both 13-week periods.

Basis of Presentation

The condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and note disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements and the accompanying notes are unaudited and should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company s Annual Report on Form 10-K for the year ended September 29, 2006. In the opinion of management, the condensed consolidated financial statements herein include adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company s financial position as of March 30, 2007 and September 29, 2006, results of operations for the three and six months ended March 30, 2007 and March 31, 2006, and cash flows for the six months ended March 30, 2007 and March 31, 2006. The results of operations for the three and six months ended March 30, 2007 are not necessarily indicative of the operating results to be expected for the full fiscal year or any future periods.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

Goodwill and Intangible Assets

The Company evaluates goodwill and purchased assets with indefinite lives for impairment annually in accordance with Statement of Financial Accounting Standards (SFAS) No. 142 Goodwill and Other Intangible Assets (SFAS 142). The impairment test for goodwill is a two-step process. Step one consists of a comparison of the fair value of a reporting unit with its carrying amount, including the goodwill allocated to each reporting unit. The Company determines the fair value of its reporting units based on the present value of estimated future cash flows of the reporting units. The reporting units are consistent with the reportable operating segments identified in Note 14 Segment Information . If the carrying amount is in excess of the fair value, step two requires the comparison of the implied fair value of the reporting unit with 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. We performed such evaluations for the two reporting units that carried goodwill in the fourth quarter of fiscal year 2006, Oncology Systems and X-ray Products, and found no impairment. 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.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

Purchased intangible assets are carried at cost, net of accumulated amortization. Intangible assets with finite lives are amortized over their estimated useful lives of approximately two to twenty years using the straight-line method.

Revenue Recognition

The Company s revenues are derived primarily from hardware and software products sales and contract services of Oncology Systems products, X-ray products, Security and Inspection products, proton therapy contracts and scientific instruments contracts.

Hardware Products

The Company recognizes revenues for hardware products in accordance with Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition* (SAB 104) when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable and collectibility is reasonably assured. For an arrangement with multiple deliverables, the Company recognizes product sales in accordance with Emerging Issues Task Force No. 00-21, Revenue Arrangements with Multiple Deliverables (EITF 00-21) with revenues allocated among the different elements. The Company typically requires its customers to provide a down payment prior to transfer of risk of loss of ordered products or prior to performance under service contracts. These down payments are recorded as Advance payments from customers in the Condensed Consolidated Balance Sheets.

For Oncology Systems and Security and Inspection hardware products with installation obligations, the Company recognizes as revenues a portion of the product purchase price upon transfer of risk of loss and defers revenue recognition on the portion associated with product installation until acceptance, provided that all other criteria for revenue recognition under SAB 104 and EITF 00-21 are met. The portion deferred is the greater of the fair market value of the installation services for such products or the amount of payment contractually linked to the acceptance. However, when (a) all of the purchase price for the hardware product is conditioned upon acceptance, (b) the hardware product does not have value to the customer on a standalone basis, or (c) there is no objective and reliable evidence of the fair value of the undelivered item, the Company defers all revenues until acceptance in accordance with the treatment for delivered items under EITF 00-21.

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

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

The Company does not have installation obligations for X-ray tubes, digital image detectors, spare parts and certain hardware products in Oncology Systems and Security and Inspection Products (SIP) business. For the products that do not include installation obligations, the Company recognizes revenues upon the transfer of risk of loss, which is either at the time of shipment or delivery, depending upon the shipping terms of the contract, provided that all other criteria under SAB 104 and EITF 00-21 are met.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

Software Products

The Company recognizes revenues for software products in accordance with Statement of Position (SOP) No. 97-2, *Software Revenue Recognition* (SOP 97-2), as amended by SOP No. 98-9, *Software Revenue Recognition with Respect to Certain Agreements*. The Company recognizes license revenues when all of the following criteria are met: persuasive evidence of an arrangement exists, the vendor s fee is fixed or determinable, collection of the related receivable is probable, delivery of the product has occurred and the Company has received from the customer an acceptance form acknowledging installation and substantial conformance with the Company s specifications (as set forth in the user manual) for such product, or upon verification of installation when customer acceptance is not required to be received, provided that all other criteria for revenue recognition under SOP 97-2 have been met. Revenues earned on software arrangements involving multiple elements are allocated to each element based on vendor-specific objective evidence of the fair value (VSOE), which is based on the price charged when the same element is sold separately. In instances when evidence of VSOE of all undelivered elements exists, but evidence does not exist for one or more delivered elements, revenues are recognized using the residual method. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue. Revenue allocated to maintenance and support is recognized ratably over the maintenance term (typically one year).

Installation of the Company s software products involves a certain amount of customer-specific implementation to enable the software product to function within the customer s operating environment (*i.e.*, with the customer s information technology network and other hardware, with the customer s data interfaces and with the customer s administrative processes) and substantially in conformance with the Company s specifications (as set forth in the user manual) for such product. With the Company s software products, customers do not have full use of the software (*i.e.*, functionality) until the software is installed as described above and functioning within the customer s operating environment. Therefore, the Company recognizes 100% of software revenues upon receipt from the customer of the Company s acceptance form acknowledging installation and such substantial conformance, or upon verification of installation when the Company is not required to receive customer acceptance, or upon the expiration of an acceptance period, provided that all other criteria for revenue recognition under SOP 97-2 have been met.

Other

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

Revenues related to certain contracts for proton therapy and scientific instruments products and services are recognized using the percentage-of-completion method in accordance with SOP 81-1, *Accounting for Performance of Construction-Type and Certain Product Type Contracts*. Revenues recognized under the percentage-of-completion method are primarily based on contract costs incurred to date compared with total estimated contract costs. Estimated losses on contracts are charged to cost of sales in the period the loss is identified.

Recent Accounting Pronouncements

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (SFAS 109). This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS 109. This interpretation will be effective for the Company in the first quarter of fiscal year 2008. The Company is evaluating the impact of the adoption of this interpretation on the Company s consolidated financial position, results of operations and cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact that SFAS 157 may have 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)

In September 2006, the FASB issued SFAS No. 158, *Employer s Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R)* (SFAS 158). SFAS 158 requires the Company to (a) recognize a plan s funded status in its statement of financial position, (b) measure a plan s assets and its obligations that determine the plan s funded status as of the end of the employer s fiscal year and (c) recognize changes in the funded status of a defined postretirement plan in the year in which the changes occur through other comprehensive income. The requirement to recognize the funded status of a defined benefit plan and the disclosure requirements are effective for the Company s fiscal year ending September 28, 2007. Based on the funded status of the Company s plan obligations disclosed in Note 9 of the Notes to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the fiscal year ended September 29, 2006, the estimated impact of adopting SFAS 158 would have been a decrease in total assets at September 29, 2006 of approximately $3 million, an increase in total liabilities of approximately $18 million and a reduction in stockholders equity of approximately $21 million, excluding the impact of taxes. There would have been no impact on the Company s fiscal year 2006 Consolidated Statements of Earnings or Cash Flows. The actual impact of the implementation of SFAS 158 on the fiscal year 2007 financial statements will differ from that estimate due to changes in economic assumptions such as discount rates, measurement of fair values of plan assets, and other changes in actuarial assumptions that will occur in connection with the next measurement date on September 28, 2007.

In September 2006, the SEC issued SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108), to address diversity in practice in quantifying financial statement misstatements. SAB 108 requires the quantification of misstatements based on their impact on both the balance sheet and the income statement to determine materiality. The guidance provides for a one-time cumulative effect adjustment to correct for misstatements that were not deemed material under a company s prior approach but are material under the SAB 108 approach. SAB 108 will be effective for the Company s fourth quarter of fiscal year ending September 28, 2007. The Company is assessing the potential impact that SAB 108 may have on its consolidated financial position, results of operations and cash flows. However, based on the evaluation to date, the Company believes there will be no impact at adoption on its financial statements or related disclosures.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities -Including an Amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 is effective for the Company beginning in the first quarter of 2009. The Company is currently assessing the impact SFAS 159 may have on its consolidated financial position, results of operations and cash flows.

Reclassifications

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

2. MARKETABLE SECURITIES

At March 30, 2007, the Company did not have any marketable securities. At September 29, 2006, the carrying amounts of marketable securities, which were all municipal securities, were reflected as follows:

(In millions)	September 29, 2006
Short-term marketable securities	$ 93.6
Marketable securities classified as:	
Available-for-sale	$ 90.0
Held-to-maturity	3.6

	$ 93.6

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

3. INVENTORIES

The components of inventories are as follows:

(In millions)	March 30, 2007	September 29, 2006
Raw materials and parts	$ 130.7	$ 108.5
Work-in-progress	32.9	14.4
Finished goods	104.1	66.8
Total inventories	$ 267.7	$ 189.7

4. GOODWILL AND INTANGIBLE ASSETS

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

(In millions)	March 30, 2007	September 29, 2006
Intangible Assets:		
Acquired existing technology	$ 18.9	$ 14.1
Patents, licenses and other	14.0	13.9
Customer contracts and supplier relationships	10.1	10.1
Accumulated amortization	(26.8)	(24.3)
Net carrying amount	$ 16.2	$ 13.8

The increase in gross carrying amount of intangibles assets was due to the January 2007 acquisition of ACCEL Instruments GmbH (ACCEL), which is included in Other . Amortization expense for intangible assets required to be amortized under SFAS 142 was $1.3 million and $1.4 million for the three months ended March 30, 2007 and March 31, 2006 and $2.6 million and $2.9 million for the six months ended March 30, 2007 and March 31, 2006, respectively. At March 30, 2007, the Company estimates amortization expense on a straight-line basis for the remaining six months of fiscal year 2007, fiscal years 2008 through 2011, and thereafter, to be as follows (in millions): $2.5, $3.8, $3.1, $2.6, $2.0 and $2.2.

The following table reflects the allocation of goodwill:

(In millions)	March 30, 2007	September 29, 2006
Oncology Systems	$ 125.0	$ 120.9
X-ray Products	0.5	0.5
Other	28.5	

Total	$ 154.0	$ 121.4

The increase in the carrying amount of goodwill was due to the acquisition of ACCEL and the adjustment to the purchase price of the radiotherapy equipment service business of Mitsubishi Electric Co. (MELCO) in Japan and certain other Asian and South American countries (the Service Business) related to the earn out payment. See Note 13 Business Combination for a discussion of the acquisition of ACCEL and Note 8 Commitments and Contingencies for a discussion of the adjustment to the purchase price of the Service Business.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

5. RELATED PARTY TRANSACTIONS

In fiscal years 1999 and 2000, VMS invested a total of $5 million in a three member consortium for a 20% ownership interest in dpiX Holding LLC (dpiX Holding), which in turn invested $25 million for an 80.1% ownership interest in dpiX LLC (dpiX), a supplier of amorphous silicon based thin-film transistor arrays (flat panels) for the Company s X-ray Products digital imaging subsystems and for its Oncology Systems On-Board Imager and PortalVision imaging systems. The Company purchased flat panels from dpiX totaling $4.6 million for the three months ended March 30, 2007 and $2.8 million for the three months ended March 31, 2006. Flat panels purchased from dpiX totaled $11.1 million for the six months ended March 30, 2007 and $7.3 million for the six months ended March 31, 2006. These purchases of flat panels are included as a component of Inventory in the Condensed Consolidated Balance Sheets and Cost of revenues - product in the Condensed Consolidated Statements of Earnings. VMS had the right to appoint one manager of the five person board of managers and the investment was accounted for under the equity method. In accordance with the dpiX Holding agreement, net losses were to be allocated to the other two members, in succession, until their capital accounts equaled zero, before being allocated to VMS. The dpiX Holding agreement also provided that net profits were to be allocated to the other two members, in succession, until their capital accounts equaled the net losses previously allocated, then to the three members in accordance with their ownership interests.

In September 2004, VMS acquired another member s entire 20% ownership interest in dpiX Holding for $1 million. As a result, VMS has the right to appoint two managers of the five person board of managers and its ownership interest in dpiX Holding increased to 40% with the remaining 60% being held by the other original member. When VMS acquired this additional 20% ownership interest, the capital account of the selling member was nearly zero because it was the first in the consortium to be allocated losses. However, dpiX Holding has been profitable since VMS acquired the additional 20% ownership interest. As a result, VMS was the first to be allocated net profits to recover previously allocated losses and recorded in the three months ended March 30, 2007 and March 31, 2006 income on the equity investment in dpiX Holding of $11,000 and $512,000, respectively, and in the six months ended March 30, 2007 and March 31, 2006 of $28,000 and $1,357,000, respectively, which is included in Selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings.

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

In December 2004, VMS agreed to loan $2 million to dpiX in four separate installments, bearing interest at prime rate plus 1% per annum. The principal balance is due and payable to VMS in twelve equal quarterly installments that began in October 2006; interest is payable in full according to the same quarterly schedule, but began in April 2005; and the entire principal balance, together with accrued and unpaid interest thereon and all other related amounts payable hereunder, is fully due and payable on July 10, 2009. The note receivable from dpiX totaled $1.7 million and $2 million at March 30, 2007 and September 29, 2006, respectively, and is primarily included in Other Assets in the Condensed Consolidated Balance Sheet.

In March 2006, VMS and the other member of dpiX Holding agreed in principle to invest an aggregate of $92 million in dpiX Holding for dpiX to acquire and construct a manufacturing facility in Colorado to increase its production capacity. The members contributions for this facility are based on their percentage of ownership interest in dpiX Holding. As of March 30, 2007, VMS had contributed to dpiX Holding approximately $23.2 million, which is included in Other assets. VMS expects to invest an additional $13.6 million in dpiX Holding over the next five months.

6. PRODUCT WARRANTY

The Company provides for estimated future costs of warranty obligations in accordance with FASB Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* which requires an entity to disclose and recognize a liability for the fair value of the obligation it assumes upon issuance of a guarantee. The Company warrants most of its

products for a specific period of time, usually one year, against material defects. The Company provides for the estimated future costs of warranty obligations in cost of revenues when the

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related revenues are recognized. The accrued warranty costs represent the best estimate at the time of sale of the total costs that the Company 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 include the historical experience of similar products, as well as reasonable allowance for start-up expenses. On a quarterly basis, the Company reviews the accrued warranty costs and updates the historical warranty cost trends.

The following table reflects the change in the Company s accrued product warranty during the six months ended March 30, 2007 and March 31, 2006:

	Six Months Ended	
(In millions)	**March 30, 2007**	**March 31, 2006**
Accrued product warranty, at beginning of period	$ 43.0	$ 39.4
Charged to cost of revenues	23.4	18.6
Actual product warranty expenditures	(18.9)	(18.6)
Accrued product warranty, at end of period	$ 47.5	$ 39.4

7. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company has significant transactions denominated in foreign currencies and addresses certain financial exposures through a program of risk management that includes the use of derivative financial instruments. The Company sells products throughout the world, often in the currency of the customer s country, and typically hedges many of these firmly committed foreign currency sales orders. These firmly committed foreign currency sales orders are hedged using forward exchange contracts. The Company enters into foreign currency forward exchange contracts primarily to reduce the effects of fluctuating foreign currency exchange rates. The Company does not enter into forward exchange contracts for speculative or trading purposes. The forward exchange contracts range from one to twelve months in maturity. As of March 30, 2007, the Company did not have any forward exchange contracts with an original maturity greater than twelve months. As international deliveries may extend beyond twelve months, the Company may hedge beyond twelve months in the future.

The Company accounts for its hedges of foreign currency denominated sales orders (firm commitments) as fair value hedges as prescribed by SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 149, *Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities* (SFAS 133). For the three and six months ended March 30, 2007, there were no material gains or losses due to hedge ineffectiveness. At March 30, 2007, the Company had foreign exchange forward contracts for fair value hedges with notional values to sell and purchase $244.0 million and $11.4 million, respectively, in various foreign currencies. At March 30, 2007, all open forward exchange contracts were deemed effective.

The Company also hedges balance sheet exposures from its various foreign subsidiaries and business units. The Company enters into monthly foreign currency forward exchange contracts to minimize the short-term impact of foreign currency fluctuations on assets and liabilities denominated in currencies other than the U.S. dollar functional currency. These hedges of foreign-currency-denominated assets and liabilities do not qualify for hedge accounting treatment under SFAS 133. For derivative instruments not designated as hedging instruments, changes in their fair values are recognized in Selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings.

Changes in the values of these hedging instruments are offset by changes in the values of foreign currency denominated assets and liabilities. Variations from the forecasted foreign currency assets or liabilities, coupled with a significant currency movement, may result in a material gain or loss if the hedges are not effectively offsetting the change in value of the foreign currency asset or liability.

Other than foreign exchange hedging activities, the Company has no other freestanding or embedded derivative instruments.

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8. COMMITMENTS AND CONTINGENCIES

Commitments

Following a decision by MELCO to exit the radiotherapy equipment and service business and its desire to do so in a nondisruptive manner with an established radiotherapy equipment service provider, the Company entered into two separate transactions with MELCO contemporaneously whereby (i) the Company purchased the Service Business to service MELCO s existing customers and (ii) the Company formed a three-year joint venture (JVA) in Japan with MELCO that was effective as of February 3, 2004.

On February 2, 2004, the Company s Japanese subsidiary (VMS KK) purchased the Service Business for 2.0 billion Japanese Yen, or US$19.1 million, plus a contingent earn out payable to MELCO at the end of the three-year JVA period. This earn out payment is equivalent to 100% of the net profits or losses of the Service Business for the three-year period. The Company accounted for the purchase of the Service Business as an acquisition and 100% of the profits and losses from VMS KK are reflected in the Company s consolidated results. The Company accounted for the earn out payment equivalent to 100% of the net profits or losses of the Service Business during the three-year period as an adjustment to the purchase price of the acquisition at the end of the period. For the period from February 2, 2004 to February 2, 2007, net profits for the Service Business totaled approximately $4.1 million, which was recorded as an adjustment to goodwill in the second quarter of fiscal year 2007. The Company expects to make the earn out payment to MELCO in the third quarter of fiscal year 2007.

In addition to purchasing the Service Business, the Company entered into a distributor arrangement with MELCO to sell MELCO radiotherapy equipment products through VMS KK for two years. During that two-year period ended February 2, 2006, the Company did not sell any MELCO radiotherapy equipment products.

The JVA was accomplished through MELCO s purchase on February 3, 2004 of a 35% ownership interest in VMS KK for 1.4 billion Japanese Yen, or US$13.5 million. During the three-year JVA period, MELCO was not entitled to any profits or losses generated by VMS KK. However, MELCO was entitled to elect one of the five members of VMS KK s board of directors. At the end of the three-year JVA period, MELCO was required to unconditionally sell and the Company was required to unconditionally repurchase MELCO s 35% ownership interest in VMS KK at the original sale price (1.4 billion Japanese Yen) and there were no settlement alternatives to such a repurchase obligation. The Company accounted for MELCO s 35% ownership interest as a mandatorily redeemable financial instrument, which was included in Accrued expenses in the Condensed Consolidated Balance Sheets. On February 2, 2007, the Company repurchased the 35% ownership interest in the JVA from MELCO for 1.4 billion Japanese Yen, or US$11.8 million.

Contingencies

The U.S. Environmental Protection Agency (EPA) or third parties have named the Company as a potentially responsible party (PRP) under the Comprehensive Environmental Response Compensation and Liability Act of 1980, as amended (CERCLA), at eight sites where the Company, as Varian Associates, Inc., is alleged to have shipped manufacturing waste for recycling or disposal, and as a PRP the Company may have an obligation to reimburse the EPA or other third parties for cleanup costs at these sites. In addition, the Company is overseeing environmental cleanup projects and, as applicable, reimbursing third parties for cleanup activities under the direction of, or in consultation with, federal, state and/or local agencies at certain current VMS or former Varian Associates, Inc. facilities (including facilities disposed of in connection with the Company s sale of its Electron Devices business during 1995 and the sale of its thin film systems business during 1997). Under the terms of the agreement governing the spin-offs of Varian, Inc. (VI) and Varian Semiconductor Equipment Associates, Inc. (VSEA), by the Company in 1999, VI and VSEA are each obligated to indemnify the Company for one-third of these environmental cleanup costs (after adjusting for any insurance proceeds realized or tax benefits recognized by the Company). The Company spent $0.3 million and $0.2 million (net of amounts borne by VI and VSEA) during the three months ended March 30, 2007 and March 31, 2006, respectively, on environmental cleanup costs, third-party claim costs, project management costs and legal costs. The Company spent $0.5 million and $0.6 million (net of amounts borne by VI and VSEA) during the six months ended March 30, 2007 and March 31, 2006, respectively, on environmental cleanup costs, third-party claim costs, project management costs and legal costs.

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Various uncertainties make it difficult to estimate the likelihood or cost of certain third-party claims, project management costs and legal costs at all of the sites and facilities. In addition, for the eight sites and one of the facilities, various uncertainties make it difficult to assess the likelihood and scope of further cleanup activities or to estimate the future cost of such activities. As of March 30, 2007, the Company nonetheless estimated that the Company s future exposure (net of VI s and VSEA s indemnification obligations) for the cleanup costs, third party-claims, project management costs and legal costs for these nine locations ranged in the aggregate from $3.6 million to $7.2 million. The time frames over which these cleanup project costs are estimated vary ranging from one year up to 14 years as of March 30, 2007. Management believes that no amount in the foregoing range of estimated future costs is more probable of being incurred than any other amount in such range and therefore accrued $3.6 million for these cleanup projects as of March 30, 2007. The amount accrued has not been discounted to present value due to the uncertainties that make it difficult to develop a best estimate of future costs.

As to all other facilities, the Company has gained sufficient knowledge to better estimate the scope and costs of future cleanup activities based upon formal agreements with other parties defining the Company s future liabilities or formal cleanup plans that have either been approved by or completed in accordance with the requirements of the state or federal environmental agency with jurisdiction over the facility. As of March 30, 2007, the Company estimated that the Company s future exposure (net of VI s and VSEA s indemnification obligations) for the cleanup costs at these facilities, and reimbursements of third party s claims for these facilities, ranged in the aggregate from $9.4 million to $36.0 million. The time frames over which these cleanup project costs are estimated vary, ranging from 2 years to 30 years as of March 30, 2007. As to each of these facilities, management determined that a particular amount within the range of estimated costs was a better estimate of the future environmental liability than any other amount within the range, and that the amount and timing of these future costs were reliably determinable. The best estimate within the range was $17.3 million at March 30, 2007. The Company accordingly accrued $11.7 million, which represents its best estimate of the future costs of $17.3 million discounted at 4%, net of inflation. This accrual is in addition to the $3.6 million described in the preceding paragraph.

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

Although any ultimate liability arising from environmental-related matters described herein could result in significant expenditures that, if aggregated and assumed to occur within a single fiscal year would be material to the Company s consolidated financial statements, the likelihood of such occurrence is considered remote. Based on information currently available to management and its best assessment of the ultimate amount and timing of environmental-related events (and assuming VI and VSEA satisfy their indemnification obligations), management believes that the costs of these environmental-related matters are not reasonably likely to have a material adverse effect on the consolidated financial statements of the Company in any fiscal year.

The Company evaluates its liability for environmental-related investigation and cleanup costs in light of the liability and financial strength of potentially responsible parties and insurance companies with respect to which the Company believes that it has rights to contribution, indemnity and/or reimbursement (in addition to the obligations of VI and VSEA). Claims for recovery of environmental investigation and cleanup costs already incurred, and to be incurred in the future, have been asserted against various insurance companies and other third parties. The Company receives certain cash payments in the form of settlements and judgments from defendants, its insurers and other third parties from time to time. The Company has also reached an agreement with another insurance company under which the insurance company has agreed to pay a portion of the Company s past and future environmental-related expenditures, and the Company therefore recorded a $2.8 million receivable at March 30, 2007, which was included in Other assets . The Company believes that this receivable is recoverable because it is based on a binding, written settlement agreement with a solvent and financially viable insurance company and the insurance company has in the past paid the claims that the Company has made.

The Company is also involved in other legal proceedings arising in the ordinary course of its business. While there can be no assurances as to the ultimate outcome of any litigation involving the Company, management does not believe any pending legal proceeding will result in a judgment or settlement that would have a material adverse effect on the Company s consolidated financial position, results of operations or cash flows.

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9. RETIREMENT PLANS

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

	Three Months Ended		Six Months Ended	
(In thousands)	March 30, 2007	March 31, 2006	March 30, 2007	March 31, 2006
Defined Benefit Plans				
Service cost	$ 1,219	$ 929	$ 2,404	$ 1,858
Interest cost	1,063	844	2,106	1,688
Expected return on plan assets	(1,126)	(841)	(2,253)	(1,682)
Amortization of transition amount		(2)		(4)
Amortization of prior service cost	30	32	61	64
Recognized actuarial loss	235	213	471	426
Net pension benefit cost	$ 1,421	$ 1,175	$ 2,789	$ 2,350
Post-Retirement Benefit Plans				
Interest cost	94	71	188	142
Amortization of transition amount	123	123	246	246
Amortization of prior service cost	1	1	2	2
Recognized actuarial (gain)/loss	6	(1)	11	(2)
Net pension benefit cost	$ 224	$ 194	$ 447	$ 388

The Company made contributions to the defined benefit plans of $3.6 million during the six months ended March 30, 2007. The Company currently expects total contributions to the defined benefit plans for fiscal year 2007 will be approximately $12.6 million. The Company made contributions to the post-retirement benefit plans of $0.3 million during the six months ended March 30, 2007. The Company currently expects total contributions to the post-retirement benefit plans for fiscal year 2007 will be approximately $0.5 million.

10. STOCKHOLDERS EQUITY

Stock Repurchase Program

On November 20, 2006, the Company announced that its Board of Directors had approved the repurchase of 4,500,000 shares of VMS common stock over the period through September 28, 2007 in addition to the 1,500,000 shares of common stock that had been available for repurchase as of September 29, 2006 under the prior program. During the six months ended March 30, 2007, the Company paid $152.9 million to repurchase 3,100,000 shares of VMS common stock, of which $76.3 million was paid during the three months ended March 30, 2007 to repurchase 1,600,000 shares. All shares that have been repurchased have been retired. As of March 30, 2007, the Company could repurchase up to 2,900,000 shares of VMS common stock under the November 20, 2006 authorization.

Comprehensive Earnings

Comprehensive earnings for the three and six months ended March 30, 2007 and March 31, 2006 equaled the reported net earnings.

11. EMPLOYEE STOCK PLANS

In February 2007, VMS s stockholders approved the Second Amended and Restated 2005 Omnibus Stock Plan (the Second Amended 2005 Plan), which modified the Amended and Restated 2005 Omnibus Stock Plan (the Amended 2005 Plan) to (i) increase the number of shares available for grant under the plan by 2,650,000 shares, (ii) explicitly prohibit the repricing of stock options and stock appreciation rights without the approval of VMS s stockholders, (iii) change the number of shares counted against the available-for-grant limit from three shares to 2.5 shares for every one share issued in connection with

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awards other than stock options and stock appreciation rights, (iv) change the expiration date of stock options from a maximum of ten years to a maximum of seven years from the date of grant (v) cease to increase the number of shares available for grant under the plan by the number of shares tendered to VMS as payment for the exercise of stock options or in satisfaction of a tax withholding obligation pursuant to stock awards and (vi) change definition of Fair Market Value, which is also used to determine exercise price for stock options, to the last quoted price of the underlying shares on the stock market on the next preceding date, if the stock market was closed on the grant date. Prior to stockholder approval of the Second Amended 2005 Plan, if stock options were granted on a date which the stock market was closed, the exercise price was equal to the average of the highest and lowest quoted selling prices on the stock market on the day before and the day after the grant date.

Effective October 1, 2005, the Company adopted SFAS No. 123(R) Share-Based Payment (SFAS 123(R)), which requires the measurement and recognition of compensation expense for all share-based payment awards made to the Company s employees and VMS directors including stock options and employee stock purchases under the Employee Stock Purchase Plan, deferred stock units and restricted stock based on fair values.

The table below summarizes the effect of recording share-based compensation expense under SFAS 123(R), which is allocated as follows:

	Three Months Ended		Six Months Ended	
(In thousands, except per share amounts)	**March 30, 2007**	**March 31, 2006**	**March 30, 2007**	**March 31, 2006**
Cost of revenues - Product	$ 1,097	$ 1,164	$ 2,243	$ 1,584
Cost of revenues - Service contracts and other	888	778	1,754	1,394
Research and development	1,212	1,149	2,560	2,093
Selling, general and administrative	8,873	8,629	16,459	14,805
Taxes on earnings	(4,109)	(4,219)	(7,853)	(6,910)
Net decrease in net earnings	$ 7,961	$ 7,501	$ 15,163	$ 12,966
Increase (decrease) on:				
Cash flows from operating activities	$ (4,881)	$ (18,835)	$ (12,513)	$ (43,455)
Cash flows from financing activities	$ 4,881	$ 18,835	$ 12,513	$ 43,455

During the three and six months ended March 30, 2007, total share-based compensation expense recognized in earnings before taxes was $12.1 million and $23.0 million, respectively, and the total related recognized tax benefit was $4.1 million and $7.8 million, respectively. During the three and six months ended March 31, 2006, total share-based compensation expense recognized in earnings before taxes was $11.7 million and $19.9 million, respectively, and the total related recognized tax benefit was $4.2 million and $6.9 million, respectively. Total share-based compensation expense capitalized as part of inventory for the three and six months ended March 30, 2007 was $0.7 million and $1.3 million, respectively. Total share-based compensation expense capitalized as part of inventory for the three and six months ended March 31, 2006 was $0.6 million and $1.1 million, respectively.

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

	Three Months Ended		Six Months Ended	
	March 30, 2007	March 31, 2006	March 30, 2007	March 31, 2006
Employee Stock Option Plans				
Expected term (in years)	4.20	4.25	4.31	4.18
Risk-free interest rate	4.7%	4.5%	4.6%	4.4%
Expected volatility	28.7%	29.2%	29.3%	29.3%
Expected dividend				
Weighted average fair value at grant date	$ 15.40	$ 17.65	$ 16.00	$ 15.50
Employee Stock Purchase Plan				
Expected term (in years)	0.50	0.50	0.50	0.50
Risk-free interest rate	5.1%	4.8%	5.0%	4.5%
Expected volatility	18.7%	27.8%	20.3%	26.5%
Expected dividend				
Weighted average fair value at grant date	$ 10.09	$ 9.33	$ 10.58	$ 9.17

Activity under the Omnibus Stock Plan, the 2000 Stock Option Plan, the 2005 Omnibus Stock Plan, the Amended 2005 Plan and the Second Amended 2005 Plan (together, the Employee Stock Plans) is presented below:

		Options Outstanding			
(In thousands, except per share amounts)	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (3)
Balance at September 29, 2006	3,816	15,111	$ 28.90		
Authorized	2,650				
Granted (1)	(2,767)	2,551	50.62		
Cancelled or expired (2)	101	(98)	42.55		
Exercised		(1,077)	16.98		
Balance at March 30, 2007	3,800	16,487	$ 32.96	6.3	$ 257,245
Exercisable at March 30, 2007		12,077	$ 27.06	5.3	$ 252,835

(1) During the six months ended March 30, 2007, VMS granted to certain employees an aggregate of 54,805 shares of restricted common stock under the Amended 2005 Plan and an aggregate of 2,750 shares of restricted common stock under the Second Amended 2005 Plan. In addition, VMS awarded to its directors an aggregate of 18,000 deferred stock units under the Second Amended 2005 Plan.

(2) During the six months ended March 30, 2007, VMS cancelled 1,255 shares of restricted common stock that were tendered to VMS for employees taxes withheld for vested restricted common stock.

(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 $47.69 as of March 30, 2007 and which would have been received by the option holders had all option holders exercised their options as of that date.

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As of March 30, 2007, there was $53 million of total unrecognized compensation expense related to stock options granted under the Employee Stock Plans. This unrecognized compensation expense is expected to be recognized over a weighted average period of 1.9 years.

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

(In thousands, except per share amounts)	Shares	Weighted Average Grant-Date Fair Value
Balance at September 29, 2006	66	$ 46.05
Granted	76	50.41
Vested	(4)	56.48
Balance at March 30, 2007	138	$ 48.17

As of March 30, 2007, unrecognized compensation expense totaling $4.7 million was related to restricted stock and deferred stock units granted under the Employee Stock Plans. This unrecognized compensation expense is expected to be recognized over a weighted average period of 6.0 years.

12. EARNINGS PER SHARE

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

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

	Three Months Ended		Six Months Ended	
(In thousands, except per share amounts)	March 30, 2007	March 31, 2006	March 30, 2007	March 31, 2006
Net earnings	$ 60,951	$ 55,798	$ 110,452	$ 96,958
Basic weighted average shares outstanding	128,205	131,926	128,689	131,492
Dilutive effect of potential common shares	3,663	4,895	3,820	4,876
Diluted weighted average shares outstanding	131,868	136,821	132,509	136,368
Net earnings per share Basic	$ 0.48	$ 0.42	$ 0.86	$ 0.74
Net earnings per share Diluted	$ 0.46	$ 0.41	$ 0.83	$ 0.71

Pursuant to SFAS 123(R), the Company excludes stock options from the computation of diluted weighted average shares outstanding if the per share value, including the sum of (a) the exercise price of the options, (b) the amount of the compensation cost attributed to future services and not yet recognized and (c) the amount of tax benefit 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 these stock options would be antidilutive to earnings per share. Accordingly, stock options to purchase 4,421,343 shares and 2,608,219 shares at average exercise prices of $50.62 and $50.35 per share, respectively, were excluded from the computation of diluted weighted average shares outstanding for the three months ended March 30, 2007 and March 31, 2006, respectively. Stock options to purchase 4,349,053 shares and 2,650,855 shares at average exercise prices of $50.46 and $50.19 per share, respectively, were excluded from the computation of diluted weighted average shares outstanding for the six months ended March 30, 2007 and March 31, 2006, respectively.

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13. BUSINESS COMBINATION

In January 2007, the Company acquired all of the outstanding equity of ACCEL, a privately-held supplier of scientific research instruments and proton therapy systems for cancer treatment in Germany, for approximately $20.5 million, plus debt assumed of $10.2 million. The acquisition of ACCEL leverages the Company s existing technology in treatment planning, image guidance and cancer informatics and it enables Varian to offer all the products needed for delivering proton therapy.

The Company s methodology for allocating the purchase price of this purchase acquisition to intangible assets is determined using commonly accepted valuation techniques in the high-technology industry. The valuation method used by the Company included the income approach which established the fair value of the assets based on the value of the cash flows that the assets can be expected to generate in the future using the discounted cash flow method. The purchase price of the transaction was allocated to the acquired assets and liabilities based on their estimated fair values as of the date of acquisition, including identifiable intangible assets, with the remaining amount being classified as goodwill. In connection with this acquisition, $28.5 million was allocated to goodwill, $4.9 million was allocated to identifiable intangible assets and ($12.9) million, net, was allocated to assets and liabilities, including $10.2 million of debt assumed. These amounts reflect a preliminary allocation of the purchase price and are subject to adjustment.

The condensed consolidated financial statements include the operating results of ACCEL from January 1, 2007, as specified in the purchase agreement. Pro forma results of operations have not been presented because the acquisition was not significant.

14. SEGMENT INFORMATION

The Company s operations are grouped into two reportable operating segments: Oncology Systems and X-ray Products. These reportable operating segments were determined based on how the Company s Chief Executive Officer, its Chief Operating Decision Maker (CODM), views and evaluates the Company s operations. The Company s Ginzton Technology Center (GTC), SIP business and the newly acquired ACCEL business are reflected in the Other category because these operations do not meet the criteria of a reportable operating segment as defined under SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131). 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		Six Months Ended	
(In millions)	**March 30, 2007**	**March 31, 2006**	**March 30, 2007**	**March 31, 2006**
Revenues				
Oncology Systems	$ 358	$ 346	$ 675	$ 623
X-ray Products	66	61	128	113
Total reportable segments	$ 424	$ 407	$ 803	$ 736
Other	19	7	28	12
Corporate				
Total company	$ 443	$ 414	$ 831	$ 748
Operating Earnings				
Oncology Systems	$ 90	$ 85	$ 159	$ 147

X-ray Products	16	12	31	21
Total reportable segments	$ 106	$ 97	$ 190	$ 168
Other	(4)	(2)	(5)	(3)
Corporate	(16)	(15)	(29)	(26)
Total company	$ 86	$ 80	$ 156	$ 139

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

15. SUBSEQUENT EVENT

On April 25, 2007, the Company announced that it has entered into an agreement to acquire Bio-Imaging Research, Inc., a privately-held supplier of X-ray imaging products for security and inspection, for approximately $21 million.

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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 March 30, 2007, and the related condensed consolidated statements of earnings for the three-month and six-month periods ended March 30, 2007 and March 31, 2006 and the condensed consolidated statement of cash flows for the six-month periods ended March 30, 2007 and March 31, 2006. 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, 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 have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of September 29, 2006, the related consolidated statements of earnings, stockholders equity and cash flows for the year then ended, management s assessment of the effectiveness of the Company s internal control over financial reporting as of September 29, 2006 and the effectiveness of the Company s internal control over financial reporting as of September 29, 2006; and in our report dated December 11, 2006 on financial statements and internal control over financial reporting, we expressed unqualified opinions thereon. The consolidated financial statements and management s assessment of the effectiveness of internal control over financial reporting referred to above are not presented herein. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of September 29, 2006, 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, California

April 27, 2007

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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 (we, our, or the Company). The outcome of the events described in these forward-looking statements is subject to risks and uncertainties. Actual results and the outcome or timing of certain events may differ significantly from those projected in these forward-looking statements or management s current expectations due to the factors cited in this Management s Discussion and Analysis of Financial Condition and Results of Operations, or MD&A, the Risk Factors listed under Part II, Item 1A of this Quarterly Report on Form 10-Q, and other factors described from time to time in our other filings with the Securities and Exchange Commission, or SEC, or other reasons, which are by this reference incorporated in this Quarterly Report on Form 10-Q. For this purpose, statements concerning industry or market segment outlook; market acceptance of or transition to new products or technology such as intensity-modulated radiation therapy, or IMRT, image-guided radiation therapy, or IGRT, brachytherapy, software, treatment techniques, stereotactic radiosurgery, filmless X-rays and security and inspection products; growth drivers; orders, revenues, backlog or earnings growth; future financial results and any statements using the terms believe, expect, expectation, anticipate, can, should, will, would, could, estimate, appear, based on, may, intended, potential , are emerging and possible or si 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

Despite modest growth in Oncology Systems net orders and revenues, strong net orders and revenue growth in X-ray Products and the Security and Inspection Products business, or SIP, as well as contribution from the newly acquired ACCEL Instruments GmbH, or ACCEL, contributed to the net order and revenue growth for the second quarter of fiscal year 2007 over the year-ago quarter. Including $47 million in acquired backlog from ACCEL, net orders for the second quarter of fiscal year 2007 were up 23% over the year-ago quarter. Excluding acquired backlog, net orders in the second quarter of fiscal year 2007 grew 12% from the second quarter of fiscal year 2006. Revenues for the second quarter of fiscal year 2007 were up 7% from the year-ago quarter and backlog at March 30, 2007 was up 19% from the end of the second quarter of fiscal year 2006. For the second quarter of fiscal year 2007, we recorded net earnings of $61 million and net earnings per diluted share of $0.46, compared to net earnings of $56 million and net earnings per diluted share of $0.41 in the year-ago quarter. In the second quarter of fiscal year 2007, gross margin was 42%, up by 0.5 percentage points with an increase over the year-ago period of approximately seven percentage points in X-ray Product gross margin as well as a small improvement in Oncology Systems gross margin.

Oncology Systems. Our largest business segment is Oncology Systems, which designs, manufacturers, sells and services hardware and software products for treating cancer with radiation, including linear accelerators, treatment simulation and verification products, brachytherapy equipment, information management and treatment planning software and other sophisticated accessory products and services.

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

Customers are recognizing IGRT and stereotactic radiosurgery as the next significant enhancements in curative radiation therapy. We believe that IGRT will continue to emerge as one of the main contributors to net orders and revenue growth in our Oncology Systems business segment, with North America ahead of international regions in the timing of IGRT adoption. As of March 30, 2007, more than 450 installations of our On-Board Imager product, or OBI, for our high-energy Clinac® accelerators and Trilogy linear accelerators, two of our products for enabling IGRT, were either complete or in progress. As of March 30, 2007, more than 100 Trilogy linear accelerators, which are configured to permit high accuracy, high speed image-guided stereotactic radiosurgery and stereotactic radiotherapy, were installed.

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Reversing our first quarter experience, Oncology Systems net orders in the second quarter of fiscal year 2007 had an unpredicted decline in North America from the year-ago quarter while second quarter international net orders grew solidly from the year-ago period, resulting in overall net orders in Oncology Systems that were flat in the second quarter and the first half of fiscal year 2007 with the year-ago periods. Oncology Systems revenues for the second quarter of fiscal year 2007 also remain relatively flat compared to the year-ago quarter, with a decline in the international regions and growth in North America. We believe we are experiencing greater variability in the length of the customers purchase cycle caused by larger dollar-value transactions for more sophisticated IGRT and surgical equipment, as well as more complex customer decision processes. Also, we are experiencing more customer-requested delays in delivery attributable to the longer preparation and renovation of treatment rooms required for the more sophisticated IGRT-equipped products. Additionally, net orders and revenues for our non-IGRT-related products has declined in the second quarter of fiscal year 2007 compared to the year-ago period. These factors impacted both net orders and revenues for the second quarter of fiscal year 2007 and we see these as issues that will affect us for the rest of the fiscal year, as more of our customers look at adopting IGRT and our backlog contains a high and growing percentage of IGRT-equipped products. We continue to believe that demand for our products that enable IGRT will remain strong in North America as this region continues to adopt new medical technology for IGRT and stereotactic radiosurgery. Additionally, as previously noted, our international regions have experienced a slowdown in demand for radiotherapy capital equipment for IMRT after several years of strong international growth driven by the rapid adoption of IMRT technology. We believe regional fluctuations in demand are consistent with the historical pattern where the international regions and North America region have different cycles of demand and technology adoption. We are, however, seeing a faster adoption rate among the technology early adopters for IGRT as compared to IMRT which may lead to more compressed growth phase cycles.

Our success in Oncology Systems largely depends upon our ability to retain leadership in technological innovation, the cost effectiveness of our products, the efficacy of our treatment technology and external economic influences. Factors affecting the adoption rate of new technologies such as IGRT could include the more-widely demonstrated efficacy of IGRT by early adopters and our internal efficiency in design, documentation and testing, deployment and installation. They may also include customer training, reimbursement and our ability to educate customers about the cost effectiveness of our new technologies and clinical outcome advantages. External economic influences could include hospital financial strength in the United States, foreign currency exchange rates, governmental healthcare policies and government budgeting and tendering cycles.

X-Ray Products. Our X-ray Products business segment manufactures and sells (i) X-ray tubes for use in a range of applications including computed tomography, or CT, scanning, radioscopic/fluoroscopic imaging, mammography, special procedures and industrial applications and (ii) flat panel digital image detectors for X-rays (commonly referred to as flat panel detectors or digital image detectors), which is an alternative to image intensifier tubes for fluoroscopy and X-ray film for radiography. We continue to view the fundamental growth driver for the component business to be the on-going success of key original equipment manufacturers, or OEMs, that incorporate our X-ray tube products and flat panel detectors into their medical diagnostic and industrial imaging systems. Our flat panel detectors are being incorporated into new filmless X-ray imaging equipment for medical diagnostics, dental imaging, veterinary care and industrial inspection.

In the second quarter of fiscal year 2007, the flat panel detector product line continued to be the primary contributor to X-ray Products solid net orders, revenues and gross margin growth over the same period of fiscal year 2006. We have completed the expansion of our Salt Lake City, Utah, manufacturing facility where our flat panel detector product line is manufactured to give us additional capacity.

We have invested $23 million as of March 30, 2007 and expect to invest an additional $14 million over the next five months into dpiX Holding LLC, or dpiX Holding, which will help fund the acquisition and construction of a new $92 million Gen 4 fabrication facility in Colorado where the next generation of amorphous silicon arrays will be produced. dpiX Holding (through its subsidiary, dpiX LLC) is a key supplier of amorphous silicon arrays for our flat panel detector products and we are a 40% equity owner in dpiX Holding.

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. Factors affecting the success of our X-ray Products business include our ability to develop products with lower cost, better quality and superior technology and performance, and to maintain strong relationships with our OEM customers.

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Other. The Other category is comprised of SIP, the newly acquired ACCEL proton therapy and scientific research instruments business and the operations of the Ginzton Technology Center, or GTC (see Note 14 Segment Information of the Notes to the Condensed Consolidated Financial Statements within this Quarterly Report on Form 10-Q).

SIP designs, manufactures, sells and services Linatron® X-ray accelerators for security and inspection purposes, such as cargo screening, border protection and nondestructive examination for a variety of applications. We generally sell our Linatron X-ray accelerators to OEMs who incorporate our accelerators into their inspection systems, which are then sold to customs agencies and other government and military agencies, as well as to commercial private parties in the casting, power, aerospace, chemical, petro-chemical and automotive industries. On April 25, 2007, we announced that we entered into an agreement to acquire Bio-Imaging Research, Inc., or BIR, a privately-held supplier of X-ray imaging products for security and inspection, for approximately $21 million. This acquisition will enable us to offer security and inspection customers X-ray imaging detectors and image processing software in addition to our existing line of specialized linear accelerators for cargo screening, inspection and non-destructive testing. BIR will operate under our SIP business unit.

We believe growth in this 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. As a result, this business is heavily influenced by U.S. and foreign governmental policies on national and homeland security, border protection and customs revenue activities, which depend upon government budgets and appropriations and which are subject to political changes. While we are optimistic about the long-term potential of our SIP business and encouraged by the increased interest in our SIP products, use of this technology in security cargo screening and border protection is in its early stages. Orders and revenues for our SIP products may be unpredictable as governmental agencies may place larger orders with our OEM customers in a short time period and then may not place any orders for a long time period thereafter.

In January 2007, we completed the acquisition of ACCEL, a privately-held supplier of scientific research instruments and proton therapy systems for cancer treatment. The acquisition will enable us to offer products for delivering image-guided, intensity-modulated proton therapy for certain cancer patients. Proton therapy directs protons into the tumor and disrupts the cancer cells ability to reproduce. The ability to accurately target and kill tumor cells with less dose to nearby healthy tissue makes proton therapy a preferred option for treating certain kinds of cancers. Due to its relatively large scale, the construction of a proton therapy facility requires significant capital investment and may involve complex project financing. Therefore, sales and customer decision cycles may take several years. We believe that growth in this business will initially develop in the major metropolitan areas in the United States and abroad, and that this market is driven by institutions that wish to expand their clinical offering and increase their profile in their respective communities. We see a high level of interest in the marketplace world-wide for this type of technology and believe that Varian can leverage its sophisticated technology in radiation therapy into the proton therapy market, improving clinical utility for existing clinical applications and possibly expanding the use of proton therapy into a broader array of cancer types. There are several competitors in this market, some of whom may have access to government support and/or may not be as focused on maintaining profitability and are willing to forsake profitability for market share. Orders and revenues for proton therapy products may be unpredictable due to these factors.

The Scientific Instruments division of ACCEL develops, manufactures and services customized components and turnkey systems primarily for national research laboratories for fundamental and applied physics. This scientific instruments market is driven by a few large projects in the billion-dollar range and an increasing number of national accelerator projects ranging from one to five hundred million dollars. As the research projects in this market are all publicly funded, decisions on new projects or project upgrades are subject to public and political factors. In the scientific instruments market, ACCEL competes with other companies as well as the internal engineering and fabrication capabilities in the national research laboratories. While it appears that there is relatively steady growth in the number and volume of these research projects worldwide, the timing of these research projects may vary significantly. Therefore, ACCEL engineering and manufacturing resources will fluctuate over time as they adapt to the resource requirements of these research projects. Due to the above factors, orders, revenues and profitability of the ACCEL Scientific Instruments business may not be easily predictable.

GTC, our research facility for new and potential markets, 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, 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.

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The Other business category contributed significantly to revenues and net order growth in the second quarter of fiscal year 2007 over the same quarter in the fiscal year 2006. The Other category reported combined revenues of $19 million, which included a contribution of $9 million from ACCEL and was up $12 million from the year-ago quarter. Excluding $47 million of acquired backlog, the ACCEL business contributed $22 million in the second quarter of fiscal year 2007 in new net orders for proton therapy services and scientific instruments products. In our SIP business, orders for cargo screening systems in international markets and replacements of older products for industrial inspection and non-destructive testing grew significantly in the second quarter of fiscal year 2007 over the year-ago period.

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 report, as well as the Consolidated Financial Statements and the Notes to the Consolidated Financial Statements and the related Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended September 29, 2006, 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 generally accepted accounting principles in the United States of America, or GAAP, requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and assumptions are based on historical experience and on various other factors that we believe are reasonable under the circumstances. We periodically review our accounting policies and estimates and make adjustments when facts and circumstances dictate. Our critical accounting policies that are affected by accounting estimates include share-based compensation expense, revenue recognition, valuation of allowance for doubtful accounts, valuation of inventories, assessment of recoverability of goodwill and intangible assets, valuation of warranty obligations, assessment of environmental remediation liabilities, valuation of defined benefit and post-retirement benefit plans and valuation of taxes on earnings. Such accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of our Condensed Consolidated Financial Statements, and actual results could differ materially from these estimates. For a discussion of how these estimates and other factors may affect our business, also see the Risk Factors listed under Part II, Item 1A of this Quarterly Report on Form 10-Q.

Share-based Compensation Expense

Effective October 1, 2005, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment,* or SFAS 123(R), using the modified prospective transition method. We have valued our share-based payment awards granted beginning in fiscal year 2006 using the Black-Scholes option-pricing model. The determination of fair value of share-based payment awards on the date of grant using the Black-Scholes option-pricing model is affected by VMS s stock price as well as the input of other subjective assumptions, including the expected term of stock awards and the expected price volatility of VMS stock over the expected term of the awards.

The expected term is based on the observed and expected time to post-vesting exercise and post-vesting cancellations of stock options by our employees. Upon the adoption of SFAS 123(R), we determined the expected term of stock options based on the demographic grouping of employees and retirement eligibility. Upon adoption of SFAS 123(R), we used a combination of historical and implied volatility, or blended volatility, in deriving the expected volatility assumption. The blended volatility represents the weighted average of implied volatility and historical volatility. Implied volatility was derived based on six-month traded options on VMS common stock. Implied volatility is weighted in the calculation of blended volatility based on the ratio of the six-month term of the exchange-traded options to the expected lives of the employee stock options. Historical volatility represents the remainder of the weighting. Our decision to incorporate implied volatility was based on our assessment that implied volatility of publicly traded options in our common stock is reflective of market conditions and is generally reflective of both historical volatility and expectations of how future volatility will differ from historical volatility. In determining the extent of use of implied volatility, we considered: (i) the volume of market activity of traded options; (ii) the ability to reasonably match the input variables of traded options to those of stock options granted by us, including the date of grant; (iii) the similarity of the exercise prices; and (iv) the length of term of traded options. After considering the above factors, we determined that we cannot rely exclusively on implied volatility based on that fact that the term our six-month exchange-traded options is less than one year and that it is different from the expected lives of the stock options granted by us. Therefore, we believe a combination of the historical volatility over the expected lives of the stock options granted by us and the implied volatility of six-month exchange-traded options best reflects the expected volatility of our stock going forward. The risk-free interest rate assumption is based upon observed interest rates

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appropriate for the term of our stock options. The dividend yield assumption is based on our history and expectation of dividend payouts. If factors change and we employ different assumptions in the application of SFAS 123(R) in future periods, the compensation expense that we record under SFAS 123(R) may differ significantly from what we have recorded in the current period. In addition, we are required to estimate the expected forfeiture rate and recognize expense only for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the stock-based compensation expense could be significantly different from what we have recorded in the current period.

Revenue Recognition

We frequently enter into sales arrangements with customers that contain multiple elements or deliverables such as hardware, software and services. Judgments as to the allocation of the proceeds received from an arrangement to the multiple elements of the arrangement, the determination of whether any undelivered elements are essential to the functionality of the delivered elements and the appropriate timing of revenue recognition are critical in respect to these arrangements to ensure compliance with GAAP. In addition, the amount of product revenues recognized is affected by our judgments as to whether objective and reliable evidence of fair value exists for hardware products and vendor-specific objective evidence of the fair value for software products in arrangements with multiple elements. Changes to the elements in an arrangement and the ability to establish objective and reliable evidence of fair value or vendor-specific objective evidence of the fair value for those elements could affect the timing of revenue recognition. Revenue recognition also depends on the timing of shipment and is subject to customer acceptance and the readiness of customers facilities. If shipments are not made on scheduled timelines or if the products are not accepted by the customer in a timely manner, our reported revenues may differ materially from expectations. In addition, revenues recognized related to contracts for certain proton therapy and scientific instruments products and services under the percentage of completion method involves considerable use of estimates in determining revenues, costs and profits and in assigning the amounts to accounting periods and, as a result, our recorded revenues may be adjusted in later periods in the event that our cost estimates prove to be inaccurate or a contract is terminated.

Allowance for Doubtful Accounts

Credit evaluations are undertaken for all major sale transactions before shipment is authorized. Normal payment terms usually require payment of a small portion of the total amount due upon signing of the purchase order contract, a significant amount upon transfer of risk of loss 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 the future ability to collect outstanding receivables, additional provisions may be needed and our future operating results could be negatively impacted.

Inventories

Our inventories include high technology parts and components that are specialized in nature or 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 companies that we have acquired have not had significant identified tangible assets and, as a result, a significant portion of the purchase price has been typically allocated 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 goodwill if indicators of impairment exist. As a result of business acquisitions, the allocation of the purchase price to goodwill and intangible assets could have a significant impact on our future operating results. The allocation of the purchase price of the acquired companies to goodwill and intangible assets requires us to make significant estimates and assumptions, including estimates of future cash flows expected to be generated by the acquired assets and the appropriate discount rate for these cash flows. Should conditions be different from management s estimates at the time of the acquisition, material write-downs of intangible assets and/or goodwill may be required, which would adversely affect our operating results.

We evaluate goodwill and purchased assets with indefinite lives for impairment annually in accordance with SFAS 142 Goodwill and Other Intangible Assets. The impairment test for goodwill is a two-step process. Step one consists of a

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comparison of the fair value of a reporting unit with its carrying amount, including the goodwill allocated to each reporting unit. We determine the fair value of its reporting units based on the present value of estimated future cash flows of the reporting units. The reporting units are consistent with the reportable operating segments identified in Note 14 Segment Information . If the carrying amount is in excess of the fair value, step two requires the comparison of the implied fair value of the reporting unit with the carrying amount of the reporting unit s goodwill. Any excess of the carrying value of the reporting unit s goodwill over the implied fair value of the reporting unit s goodwill is recorded as an impairment loss. The impairment test for intangible assets with indefinite useful lives, if any, consists of a comparison of fair value to carrying value, with any excess of carrying value over fair value being recorded as an impairment loss. We will continue to make assessments of impairment on an annual basis in the fourth quarter of our fiscal years or more frequently if indicators of potential impairment arise. We performed such evaluations for the two reporting units that carried goodwill in the fourth quarter of fiscal year 2006, Oncology Systems and X-ray Products, and found no impairment.

Warranty Obligations

We warrant most of our products for a specific period of time, usually one year, 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 we were required to accrue additional warranty cost in the future, it would negatively impact our operating results.

Environmental Matters

We are subject to a variety of environmental laws around the world regulating the handling, storage, transport and disposal of hazardous materials that do or may create increased costs for some of our operations. Environmental remediation liabilities are recorded when environmental assessments and/or remediation efforts are probable and the costs of these assessments or remediation efforts can be reasonably estimated, in accordance with Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies,* and the American Institute of Certified Public Accountants, Statement of Position 96-1, *Environmental Remediation Liabilities.* The accrued environmental costs represent our best estimate as to the total costs of remediation and the time period over which these costs will be incurred. On a quarterly basis, we review these accrued balances. If we were required to accrue additional environmental remediation costs in the future, it would negatively impact our operating results.

Defined Benefit and Post-Retirement Benefit Plans

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

The expected rates of return on the various defined benefit pension plans assets are based on the asset allocation of each plan and the long-term projected return of those assets. The discount rate enables us to state expected future cash flows at a present value on the measurement date. The discount rates used for defined benefit plans in all countries are based on 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 at longer durations, the discount rate also takes into account the yield of long-term government bonds corresponding to the duration of the benefit obligations and the difference between the yield curve on high quality corporate fixed-income investments and government fixed-income investment. A lower discount rate increases the present value of benefit obligations.

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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 calculation of our tax liabilities involves addressing uncertainties in the application of complex tax regulations. We maintain reserves for potential tax contingencies arising in the jurisdictions in which we do business. Such reserves are based on our assessment of the likelihood of an unfavorable outcome and the potential loss from such contingencies, and may be adjusted from time to time in light of changing facts and circumstances. These reserves are maintained until such time as the matter is settled or the statutory period for adjustment has passed. Adjustments could be required in the future if we determine that our reserves for tax contingencies are inadequate. The provision for taxes on earnings includes the effect of changes to these reserves that are considered appropriate.

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

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

Results of Operations

Fiscal Year

Our fiscal year is the 52- or 53-week period ending on the Friday nearest September 30. Fiscal year 2007 is the 52-week period ending September 28, 2007, and fiscal year 2006 was the 52-week period ended September 29, 2006. The fiscal quarters ended March 30, 2007 and March 31, 2006 were both 13-week periods.

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Discussion of Financial Data for the Second Quarter and First Six Months of Fiscal Year 2007 Compared to the Second Quarter and First Six Months of Fiscal Year 2006

Total Revenues

Revenues by sales classification

(Dollars in millions)	Three Months Ended March 30, 2007	Three Months Ended March 31, 2006	Percent Change	Six Months Ended March 30, 2007	Six Months Ended March 31, 2006	Percent Change
Product	$ 359.4	$ 351.8	2%	$ 677.2	$ 626.7	8%
Service Contracts and Other	83.2	62.1	34%	153.3	121.4	26%
Total Revenues	$ 442.6	$ 413.9	7%	$ 830.5	$ 748.1	11%
Product as a percentage of total revenues	*81%*	*85%*		*82%*	*84%*	
Service Contracts and Other as a percentage of total revenues	*19%*	*15%*		*18%*	*16%*	
Revenues by region						
North America	$ 222.6	$ 202.3	10%	$ 418.7	$ 375.4	12%
Europe	120.0	117.6	2%	241.5	200.4	21%
Asia	76.8	71.2	8%	135.6	134.6	1%
Rest of world	23.2	22.8	2%	34.7	37.7	(8%)
Total International (1)	220.0	211.6	4%	411.8	372.7	10%
Total	$ 442.6	$ 413.9	7%	$ 830.5	$ 748.1	11%
North America as a percentage of total revenues	*50%*	*49%*		*50%*	*50%*	
International as a percentage of total revenues	*50%*	*51%*		*50%*	*50%*	

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

Total revenues for the second quarter and the first six months of fiscal year 2007 increased over total revenues for the same periods of fiscal year 2006 due to the increases in revenues in all business segments and the Other category, which includes the newly acquired ACCEL.

Increases in product revenue from X-ray Products and SIP accounted for the increase in our product revenue in the second quarter of fiscal year 2007 over the second quarter of fiscal year 2006 while both of our business segments and SIP contributed to the product revenue increase in the first half of fiscal year 2007 over the year-ago period. Oncology Systems and the Other category contributed to the increase in service contracts and other revenues in the second quarter and in the first six months of fiscal year 2007 over the same periods in fiscal year 2006. Service contracts and other revenues grew at a higher rate than product revenues due to the increase in Oncology System service contract revenues, as well as the contribution from ACCEL. The inclusion of ACCEL contract revenues caused service contracts and other revenues to represent a higher percentage of total revenues.

In the second quarter and the first half of fiscal year 2007, Oncology Systems continued to be the primary contributor to the growth in North American revenues over the same periods in fiscal year 2006. International revenues in the second quarter of fiscal year 2007, however, were negatively impacted by declines in the Oncology Systems international revenues, although these declines were more than offset by the growth in international revenues from X-ray Products and the Other category. For the first six months of fiscal year 2007, both segments and the Other category contributed to the international revenues growth over the first six months of fiscal year 2006 despite weakness in Asia and the rest of the world regions for Oncology Systems.

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Oncology Systems Revenues

Revenues by sales classification

(Dollars in millions)	Three Months Ended March 30, 2007	Three Months Ended March 31, 2006	Percent Change	Six Months Ended March 30, 2007	Six Months Ended March 31, 2006	Percent Change
Product	$ 286.5	$ 286.1	0%	$ 534.9	$ 504.9	6%
Service Contracts (1)	71.9	60.4	19%	140.0	117.9	19%
Total Oncology Systems revenues	$ 358.4	$ 346.5	3%	$ 674.9	$ 622.8	8%
Product as a percentage of total Oncology Systems revenues	*80%*	*83%*		*79%*	*81%*	
Service Contracts as a percentage of Oncology Systems revenues	*20%*	*17%*		*21%*	*19%*	
Oncology Systems revenues as a percentage of total revenues	*81%*	*84%*		*81%*	*84%*	

(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.

Oncology Systems product revenues for the second quarter of fiscal year 2007 were flat and in the first half of fiscal year 2007 increased 6%, in each case over the same periods in fiscal year 2006. In the second quarter and the first half of fiscal year 2007, we continued to experience higher sales volume of accessory products that enable IGRT and our Trilogy linear accelerators. In addition, in the second quarter of fiscal year 2007, as the installation process for certain products for IGRT has stabilized, we began to recognize a portion of revenues associated with these products upon shipment and only defer the amount associated with installation or customer acceptance. In the past, we had deferred 100% of the revenues related to these products until customer acceptance. This change resulted in the recognition of product revenue of approximately $11 million that would have been deferred prior to the change. The increases in product revenues were partially offset by lower sales volume of products that do not enable IGRT. Further, Oncology Systems product revenues for the second quarter of fiscal year 2007 were adversely affected due to customer-requested delays in delivery related to preparing and renovating treatment rooms for the more sophisticated products that enable IGRT.

The increase in service contracts revenues in the second quarter and the first half of fiscal year 2007 from the same periods in fiscal year 2006 was primarily driven by the increase in sophistication of our products and the success of our software products which generate annual maintenance contracts and renewals.

Revenues by region

(Dollars in millions)	Three Months Ended March 30, 2007	Three Months Ended March 31, 2006	Percent Change	Six Months Ended March 30, 2007	Six Months Ended March 31, 2006	Percent Change
North America	$ 195.7	$ 178.4	10%	$ 360.8	$ 326.8	10%
Europe	98.2	107.1	(8%)	206.4	182.8	13%
Asia	43.6	39.8	9%	77.0	79.0	(3%)
Rest of world	20.9	21.2	(2%)	30.7	34.2	(10%)
Total International	162.7	168.1	(3%)	314.1	296.0	6%
Total Oncology Systems Revenues	$ 358.4	$ 346.5	3%	$ 674.9	$ 622.8	8%

North America as a percentage of Oncology Systems revenues	*55%*	*51%*	*53%*	*52%*
International as a percentage of Oncology Systems revenues	*45%*	*49%*	*47%*	*48%*

North American region growth in the second quarter and first six months of fiscal year 2007 was due primarily to continued growth in demand for our products for IGRT. We experienced slowdown in the international markets for IMRT related products as IMRT is becoming an established methodology in the international regions.

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North American revenues grew in the second quarter and the first half of fiscal year 2007 over the same periods in prior fiscal year primarily due to the higher sales volume of products that enable IGRT (including our OBI), our Trilogy linear accelerators and service contracts revenues.

Total international revenues declined 3% in the second quarter of fiscal year 2007 from the year-ago period. The decline in international revenues was primarily due to the lower sales volume of products that enable IMRT in the European region, although this was partially offset by the higher volume of products that enable IMRT and IGRT in the Asian region. For the first half of fiscal year 2007, total international revenues increased 6% compared to the same year ago period, primarily due to the increase in Europe for products that enable IMRT and IGRT, which was partially offset by the decrease in product revenues in the Asian and rest of the world regions.

Varying cycles of higher and lower revenues between the international and North American regions is a historical pattern reflecting different technology adoption cycles and demand cycles that is consistent with the net order patterns discussed more fully in Net Order.

X-ray Products Revenues

Revenues by region

	Three Months Ended			Six Months Ended		
(Dollars in millions)	**March 30, 2007**	**March 31, 2006**	**Percent Change**	**March 30, 2007**	**March 31, 2006**	**Percent Change**
North America	$ 22.1	$ 21.5	3%	$ 48.9	$ 42.2	16%
Europe	9.1	6.7	37%	17.7	12.5	42%
Asia	32.0	31.0	3%	57.3	54.8	5%
Rest of world	2.3	1.5	54%	4.0	3.4	17%
Total International	43.4	39.2	11%	79.0	70.7	12%
Total X-ray Products Revenues	$ 65.5	$ 60.7	8%	$ 127.9	$ 112.9	13%
North America as a percentage of X-ray Products revenues	*34%*	*36%*		*38%*	*37%*	
International as a percentage of X-ray Products revenues	*66%*	*64%*		*62%*	*63%*	
X-ray Products revenues as a percentage of total revenues	*15%*	*15%*		*16%*	*15%*	

All regions contributed to the revenue growth in X-ray Products for the second quarter and the first half of fiscal year 2007 over the same year-ago periods. The growth in X-ray Products revenues was primarily driven by higher sales volume of our flat panel detectors across all of our customer sectors.

Other Revenues

Revenues by sales classification

	Three Months Ended			Six Months Ended		
(Dollars in millions)	**March 30, 2007**	**March 31, 2006**	**Percent Change**	**March 30, 2007**	**March 31, 2006**	**Percent Change**
Product	$ 7.2	$ 4.9	48%	$ 14.3	$ 8.9	61%
Service Contracts and Other (1)	11.5	1.8	517%	13.4	3.5	278%
Total Other revenues	$ 18.7	$ 6.7	176%	$ 27.7	$ 12.4	123%
Other revenues as a percentage of total revenues	*4%*	*1%*		*3%*	*1%*	

(1) Service Contracts and Other revenues include revenues associated with contracts for proton therapy and scientific instruments products and services which are recognized primarily under the percentage-of-completion method.

For our Other category, which is comprised of SIP, GTC and ACCEL, revenues for the second quarter and the first half of fiscal year 2007 increased 176% and 123%, respectively, over the same periods in fiscal year 2006 primarily due to the acquisition of ACCEL in the second quarter of fiscal year 2007, which generated $9 million of contract revenues from the scientific instruments business and the proton therapy business. The growth in revenues was also due to higher sales volume of our Linatron products to our OEM customers for cargo screening and border protection. Orders and revenues for our SIP

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products may be unpredictable as government agencies may place larger orders with our OEM customers in a short time period and then may not place any orders for a long time period thereafter. We also expect variability in order and revenues from our ACCEL business due to (i) for proton therapy, the relatively high dollar amount of each order and the large scale of the related construction project and (ii) for scientific instruments, the concentration of the overall market for these products in national research laboratories and the relatively large dollar amount of certain projects.

Gross Margin

	Three Months Ended			Six Months Ended		
(Dollars in millions)	March 30, 2007	March 31, 2006	Percent Change	March 30, 2007	March 31, 2006	Percent Change
Dollar by segment						
Oncology Systems	$ 154.1	$ 148.6	4%	$ 286.0	$ 267.2	7%
X-ray Products	27.2	21.1	29%	52.7	39.4	34%
Other	3.8	1.4	173%	6.6	3.3	96%
Gross margin	$ 185.1	$ 171.1	8%	$ 345.3	$ 309.9	11%
Percentage by segment						
Oncology Systems	*43.0%*	*42.9%*		*42.4%*	*42.9%*	
X-ray Products	*41.6%*	*34.9%*		*41.2%*	*34.9%*	
Total Company	*41.8%*	*41.3%*		*41.6%*	*41.4%*	

For the second quarter and the first six months of fiscal year 2007, total gross margin increased by 0.5 percentage points and 0.2 percentage points, respectively, from the comparable periods of fiscal year 2006, due primarily to a significant improvement in X-ray Products gross margin. Compared to the same periods in fiscal year 2006, Oncology Systems gross margin improved slightly in the second quarter of fiscal year 2007, while decreasing by about 0.5 percentage points in the first half of fiscal year 2007.

For the second quarter and the first six months of fiscal year 2007, Oncology Systems gross margin benefited from increases in service contracts gross margin and was unfavorably impacted by decreases in product gross margins over the same periods in fiscal year 2006. Compared to the year-ago periods, service gross margin increased to 44.3% from 41.8% for the second quarter of fiscal year 2007 and increased to 46.0% from 42.9% for the first half of fiscal year 2007. The improvement in service contracts gross margin was due primarily to higher volume and the continued growth in higher margin software maintenance contracts in Oncology Systems. The decrease in product gross margin was primarily due to the effect of hedging foreign currency denominated sales contracts when the orders were booked. While the weakening of the U.S. dollar positively affected our revenues, it had a negative impact on our gross margin percentage. In addition, the decrease in gross margin was due to a higher proportion of revenues associated with certain new products for IGRT, which are not yet at the gross margin level of other products.

X-ray Products gross margin in the second quarter and first six months of fiscal year 2007 increased significantly by 6.7 percentage points and 6.3 percentage points, respectively The gain in gross margin resulted from (i) increased product mix shift toward sales of the higher margin flat panel detectors, (ii) margin improvement for flat panel products driven by cost reduction efforts for certain flat panel products and (iii) leverage from high sales volume. X-ray Products gross margin will continue to be impacted by factors including sales mix between flat panel detectors and X-ray tube products, product pricing, timing of new product introduction and cost reduction initiatives. Therefore, we may not be able to sustain this record high level gross margin achieved in the first half of fiscal year 2007.

Research and Development

	Three Months Ended			Six Months Ended		
(Dollars in millions)	March 30, 2007	March 31, 2006	Percent Change	March 30, 2007	March 31, 2006	Percent Change
Research and development	$ 28.4	$ 25.0	14%	$ 55.4	$ 47.2	17%
As a percentage of total revenues	*6.4%*	*6.0%*		*6.7%*	*6.3%*	

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For the second quarter and the first six months of fiscal year 2007, the growth in research and development expenses remained in line with our revenue growth. The $3.4 million increase in research and development expenses for the second quarter of fiscal year 2007 was driven by increased spending of $1.9 million in Oncology Systems, $0.8 million in X-ray Products and $0.8 million in the Other category. The $1.9 million increase in research and development expenses in Oncology Systems for the second quarter of fiscal year 2007 compared to the second quarter of fiscal year 2006 was attributable primarily to: (a) an increase in employee headcount, materials costs and consulting expenses of $0.9 million for the development of our linear accelerator products and (b) an increase in expenses for the development of our software products of $0.8 million. The $0.8 million increase in X-ray Products was primarily due to increased expenses for development projects related to flat panel detectors. The $0.8 million increase in the Other category was primarily due to an increase of $1.1 million as a result of the acquisition of ACCEL in the second quarter of fiscal year 2007.

The $8.2 million increase in research and development expenses for the first half of fiscal year 2007 was driven by increased spending of $5.1 million in Oncology Systems, $1.8 million in X-ray Products and $1.3 million in the Other category. The $5.1 million increase in research and development expenses in Oncology Systems for the first six months of fiscal year 2007 compared to the year-ago period was attributable primarily to: (a) an increase in employee headcount, materials costs and consulting expenses of $2.0 million for the development of our linear accelerator products, (b) an increase in expenses for the development of our software products of $1.6 million, (c) an increase in development expenses in the neurosurgery market of $0.9 million and (d) an increase in grants to research facilities and universities of $0.8 million. The $1.8 million increase in X-ray Products was primarily due to increased expenses for development projects related to flat panel detectors. The $1.3 million increase in the Other category was primarily due to an increase of $1.1 million as a result of the acquisition of ACCEL in the second quarter of fiscal year 2007.

Selling, General and Administrative

	Three Months Ended			Six Months Ended		
(Dollars in millions)	**March 30, 2007**	**March 31, 2006**	**Percent Change**	**March 30, 2007**	**March 31, 2006**	**Percent Change**
Selling, general and administrative	$ 70.2	$ 66.6	5%	$ 133.4	$ 123.4	8%
As a percentage of total revenues	*15.9%*	*16.1%*		*16.1%*	*16.5%*	

The $3.6 million increase in selling, general and administrative expenses for the second quarter of fiscal year 2007 compared to the same period in fiscal year 2006 was primarily attributable to: (a) an increase in operating expenses of $2.7 due to the acquisition of ACCEL and (b) increased fees of $2.0 million related to certain commission arrangements. These increases were partially offset by a net decrease in employee-related expenses of $1.0 million resulting from a decrease of $3.4 million primarily related to the new Oncology Systems sales incentive plan, which was partially offset by an increase in employee headcount and other associated costs in Oncology Systems and corporate headquarters to support our growing business activities. Under the new plan, sales incentives are earned upon shipment as compared to receipt of the order as provided for under the old plan.

The $10.0 million increase in selling, general and administrative expenses for the first half of fiscal year 2007 compared to the same period in fiscal year 2006 was primarily attributable to: (a) a net increase in employee-related expenses of $1.8 million resulting from an increase in employee headcount and other associated costs in Oncology Systems and corporate headquarters to support our growing business activities, partially offset by a decrease of $3.1 million primarily related to the new Oncology Systems sales incentive plan, (b) an increase in operating expenses of $2.7 due to the acquisition of ACCEL, (c) increased fees of $2.4 million related to certain commission arrangements, (d) an increase in professional fees of $1.3 million largely driven by information systems projects and (e) decreased income from dpiX Holding of $1.3 million.

Interest Income, Net

	Three Months Ended			Six Months Ended		
(Dollars in millions)	**March 30, 2007**	**March 31, 2006**	**Percent Change**	**March 30, 2007**	**March 31, 2006**	**Percent Change**
Interest income, net	$ 2.0	$ 2.5	(20%)	$ 4.5	$ 4.2	6%

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The decrease in interest income, net in the second quarter of fiscal year 2007 compared to the same period in fiscal year 2006 was attributable to lower balances of cash, cash equivalents and marketable securities. The increase in interest income, net in the first six months of fiscal year 2007 compared to the same period in fiscal year 2006 was attributable to an increase in interest rates partially offset by lower balances of cash, cash equivalents and marketable securities.

Taxes on Earnings

	Three Months Ended			Six Months Ended		
	March 30, 2007	March 31, 2006	Percent Change	March 30, 2007	March 31, 2006	Percent Change
Effective tax rate	31%	32%	(1%)	31%	32%	(1%)

The effective tax rate in the second quarter of fiscal year 2007 decreased from the same period in the prior year primarily due to the inclusion of ACCEL, which we acquired in the second quarter of fiscal year 2007, in the determination of our estimated annual effective tax rate. The decrease in the effective tax rate for the first six months of fiscal year 2007 from the year-ago period was primarily due to (i) the inclusion of ACCEL in the determination of our estimated annual effective tax rate and (ii) a tax benefit recorded in the first quarter of fiscal year 2007 associated with the retrospective reinstatement of the federal research and development tax credit, which had previously expired on December 31, 2005. In general, our effective income tax rate differs from the U.S. federal statutory rate largely as a result of foreign income taxed at rates lower than the U.S. federal rate, and state income taxes. Our future effective tax rate could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets or liabilities, or changes in tax laws or interpretations thereof.

Net Earnings Per Diluted Share

	Three Months Ended			Six Months Ended		
	March 30, 2007	March 31, 2006	Percent Change	March 30, 2007	March 31, 2006	Percent Change
Net earnings per diluted share	$ 0.46	$ 0.41	12%	$ 0.83	$ 0.71	17%

The increase in net earnings per diluted share in the second quarter and the first six months of fiscal year 2007 over the same periods in fiscal year 2006 can be attributed to the increase in total revenues, the increase in gross margin, the reduction in effective tax rate and the reduction in outstanding shares of common stock due to stock repurchases.

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Net Orders

Total Net Orders (by segment and region)

(Dollars in millions)	Three Months Ended March 30, 2007	Three Months Ended March 31, 2006	Percent Change	Six Months Ended March 30, 2007	Six Months Ended March 31, 2006	Percent Change
Oncology Systems:						
North America	$ 189.6	$ 211.0	(10%)	$ 382.4	$ 373.2	2%
Total International	183.0	153.7	19%	320.4	318.2	1%
Total Oncology Systems	$ 372.6	$ 364.7	2%	$ 702.8	$ 691.4	2%
X-ray Products:						
North America	$ 21.1	$ 24.9	(15%)	$ 52.3	$ 49.7	5%
Total International	46.4	33.3	39%	82.7	63.7	30%
Total X-ray Products	$ 67.5	$ 58.2	16%	$ 135.0	$ 113.4	19%
Other:	$ 88.2	$ 5.9	1374%	$ 98.4	$ 26.3	274%
Total Net Orders:	$ 528.3	$ 428.8	23%	$ 936.2	$ 831.1	13%

Including $47 million in acquired backlog from ACCEL, our total net order in the second quarter and the first half of fiscal year 2007 grew by 23% and 13%, respectively, over the year-ago periods. Excluding acquired backlog, net orders in the second quarter and the first half of fiscal year 2007 increased by 12% and 7% from the same periods in fiscal year 2006. Despite only slight growth in net orders for Oncology Systems, net orders growth from the X-ray Products business segment and the Other category, including the orders received in the second quarter by our ACCEL business, were the primary contributors to the growth in net orders in the second quarter and the first half of fiscal year 2007 over the year-ago periods.

Reversing what occurred in the first quarter of fiscal year 2007, North American Oncology Systems experienced a 10% decline in net orders in the second quarter of fiscal year 2007 from the same period in the prior year. North American net orders for the first half of fiscal year 2007 were essentially flat compared to the year-ago period as growth in demand for products that enable IGRT were offset by declines in other products, including products for IMRT upgrades, simulators and brachytherapy products. We believe the decline in the second quarter of fiscal year 2007 was due to the greater variability in the length of our customers purchase cycle caused by larger dollar-value transactions for more sophisticated IGRT and surgical equipment and more complex customer decision processes. However, we continue to believe that IGRT will drive growth in North America as this region adopts IGRT technology.

International net orders for Oncology Systems grew by 19% in the second quarter of fiscal year 2007 over the same period in the prior year primarily due to growth in Europe and the rest of the world, partially offset by a decline in Asia. International net orders for the first half of fiscal year 2007 were essentially flat compared to the year-ago period. The international region also experienced a decline in demand for simulators and brachytherapy products which offset the growth in demand for IGRT-related products. As previously noted, our international regions have experienced a slowdown in demand for radiotherapy capital equipment for IMRT after several years of strong international growth driven by the rapid adoption of IMRT technology. Consistent with what we saw in North America, we expect net orders to be lower following a rapid IMRT adoption cycle and as IMRT becomes an established treatment methodology in the international regions. We are however also beginning to see international demand for our new products that enable IGRT (including our OBI) as these international regions enter the initial stages of adoption of IGRT. We expect that IGRT will continue to emerge as one of the main contributors to net orders and revenue growth in our Oncology Systems business segment, with North America ahead of international regions in the timing of adoption.

For the trailing twelve months ended March 30, 2007, Oncology Systems net orders increased by 8%, including a 12% increase for North America and a 3% increase for international regions. By comparison, the trailing twelve months Oncology Systems net order growth rate as of December 29, 2006 was 10%, including a 20% increase for North America and a 2% decrease for international regions. The trailing twelve-month Oncology Systems net orders growth rate as of September 29, 2006 was 13%, including a 19% increase for North America and a 6% increase for international regions. Consistent with the historical pattern, we expect that Oncology Systems net orders will continue to

experience regional fluctuations. Given the results in the first half of fiscal year 2007, we believe it is unlikely that Oncology Systems will achieve the double-digit growth rate in net orders in fiscal year 2007.

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X-ray Products have relatively short turn around from net orders to shipments. X-ray Products net orders increased during the second quarter and the first half of fiscal year 2007 compared to the same periods in fiscal year 2006 due to continued robust demand for our flat panel detectors and, to a lesser extent, increased demand for our high power, anode grounded CT scanning tubes. The flat panel detector product line has become a significant contributor to our X-ray Products business segment. We believe the flat panel detector product line will continue to experience high growth in net orders as flat panel detectors, which enable filmless X-ray imaging, replace traditional film and image-intensifier X-ray products in many medical applications.

The exceptional growth in net orders in the Other category, which is comprised of SIP, ACCEL and GTC, was primarily due to the $47 million of acquired backlog from the acquisition of ACCEL in the second quarter of 2007. Excluding the impact of acquired backlog from ACCEL, the growth in net orders in the Other category in the second quarter and the first half of fiscal year 2007 was primarily due to the $22 million of new net orders received during the second quarter of fiscal year 2007 for proton therapy services and scientific instruments from ACCEL, as well as growth in net orders for our Linatron X-ray accelerators for cargo screening and border protection and for replacements of older products for industrial inspection and non-destructive testing.

While we are optimistic about the long-term potential of our SIP business and encouraged by the increased interest in our products, use of this technology in security cargo screening and border protection is in its early stages and governmental agencies have provided limited public information about plans for adopting such technologies. Orders for our SIP products may be unpredictable as governmental agencies may place larger orders with our OEM customers in a short time period and then may not place any orders for a long time period thereafter.

Also, while we believe there is a promising market for proton therapy systems, the market for proton therapy treatment is still developing, and we expect great variability in the demand for these products due to the large scale of the related construction projects, the complexity of project financing and the resulting longer customer decision cycles when compared with our Oncology Systems business. We also expect that demand for ACCEL scientific instruments products will vary as they are tied primarily to large, government or national laboratory research projects.

We continue to believe that, as a company, we can sustain global long-term average orders growth of 10% to 15% due to fundamental market factors for growth in the radiation therapy market that we believe have remained unchanged and the growth potential of our developing businesses such as SIP, proton therapy products and flat panel detectors. In any given period, however, orders growth in either North America or international regions, or both, could be outside of this range, given the high dollar amount of individual orders particularly in our Oncology Systems, SIP and ACCEL proton therapy and scientific instruments businesses. The actual timing of sales and revenue recognition will vary significantly based on the delivery requirements of individual orders, acceptance schedule and the readiness of individual customer sites for installation of our products and are usually shorter for some types of orders, such as upgrades (*i.e.* the addition of new features or accessories to existing equipment). Thus, orders in any quarter or period are not necessarily directly correlated to the level of sales or revenues in any particular future quarter or period. Moreover, as the overall mix of net orders includes a greater proportion of software products and newly introduced Oncology Systems products such as products that enable IGRT, which typically have longer time from order to completion of installation, the average time period within which orders convert into sales could lengthen and our revenue in a specific period could be lower as a result.

Backlog

Including the backlog of the newly acquired ACCEL business, we had a backlog of $1.5 billion at March 30, 2007, an increase of 19% compared to March 31, 2006. Our Oncology Systems backlog at March 30, 2007 increased by 13% from March 31, 2006, including a 20% increase for North America and a 5% increase for international regions.

Liquidity and Capital Resources

Liquidity is the measurement of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, acquire businesses and fund continuing operations. Our sources of cash include operations, stock option exercises and employee stock purchases, borrowings and interest income. Our cash usage is actively managed on a daily basis to ensure the maintenance of sufficient funds to meet our needs.

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Cash, Cash Equivalents and Marketable Securities

The following table summarizes our cash and cash equivalents and marketable securities:

(In millions)	March 30, 2007	September 29, 2006	Increase/ (Decrease)
Cash, cash equivalents and marketable securities:			
Cash and cash equivalents	$ 289	$ 272	$ 17
Marketable securities		94	(94)
Total	$ 289	$ 366	$ (77)

The $77 million decrease in cash, cash equivalents and marketable securities in the first half of fiscal year 2007 was primarily attributable to cash used for the repurchase of our common stock of $153 million, the acquisition of ACCEL of $27 million, capital expenditures of $25 million, the repurchase of the 35% ownership interest in our Japanese subsidiary from Mitsubishi Electric Co. of $12 million, investment in dpiX Holding of $11 million for the construction of a manufacturing facility in Colorado and contribution of $4 million to the trust assets of our deferred compensation plan. These uses were significantly offset by $125 million cash generated from operating activities, $24 million of cash provided by stock option exercises and employee stock purchases and $13 million of cash provided by the excess tax benefits from share-based compensation.

At March 30, 2007, we had approximately $78 million or 27% of total cash, cash equivalents in the United States. Approximately $211 million or 73% of total cash, cash equivalents was held abroad and could be subject to additional taxation if it were repatriated to the United States.

Cash Flows

	Six Months Ended	
(In millions)	March 30, 2007	March 31, 2006
Net cash flow provided by (used in):		
Operating activities	$ 125	$ 71
Investing activities	26	(12)
Financing activities	(129)	(36)
Effects of exchange rate changes on cash and cash equivalents	(5)	
Net increase in cash and cash equivalents	$ 17	$ 23

Our primary cash inflows and outflows for the first half of fiscal years 2007, as compared to the same period of fiscal year 2006, were as follows:

We generated net cash from operating activities of $125 million in the first half of fiscal year 2007, compared to $71 million for the first half of fiscal year 2006. In accordance with SFAS 123(R), we reported excess tax benefits from shared based compensation as cash used by operating activities and cash provided by financing activities of $13 million in the first six months of fiscal year 2007, compared to $43 million for the first six months of fiscal year 2006.

The $54 million increase in net cash from operating activities during the first half of fiscal year 2007 compared to the same period of fiscal year 2006 was driven by a net change of $43 million in operating assets and liabilities (working capital items) and an increase in net earnings of $13 million, partially offset by a net decrease in non-cash items of $2 million. The $43 million net change in working capital items was primarily driven by a decrease in accounts receivable of $76 million in the first half of fiscal year 2007 compared to an increase of $25 million in the same period in the prior year and an increase in inventory of $60 million in the first half of fiscal year 2007 compared to an increase of $11 million in the year-ago period.

The major contributors to the net change in working capital items in the first six months of fiscal year 2007 were accounts receivable, inventories, accrued expenses, deferred revenues and advance payments from customers.

Accounts receivables decreased due to strong collection performance in the first half of fiscal year 2007 and the timing of product deliveries in the fourth quarter of fiscal year 2006.

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Inventories increased due to delayed deliveries of Oncology Systems products as a result of construction delays at customer sites in the second quarter of fiscal year 2007 and higher product productions to meet anticipated customer demands for both Oncology Systems and X-ray Products segments throughout the reminder of fiscal year 2007.

Accrued expenses decreased primarily due to the decrease in income taxes payable. The decrease in income taxes payable was primarily the result of estimated tax payments made during the first quarter of fiscal year 2007.

Deferred revenues decreased primarily due to higher amount of revenues recognized based on customer acceptance of our Oncology Systems products and the recognition of a portion of revenues associated with certain products that enable IGRT upon shipment beginning in the second quarter of fiscal year 2007, rather than deferring 100% of the revenues until customer acceptance.

Advance payments increased because increased orders also increase down 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 of tax and other payments. For additional discussion, see Risk Factors in Item 1A.

Investing activities provided $26 million of net cash in the first six months of fiscal year 2007, compared to $12 million used in the first half of fiscal year 2006. Our net proceeds from maturities of marketable securities were $94 million in the first six months of fiscal year 2007, compared to $12 million in the year-ago period. Cash used for purchases of property, plant and equipment was $25 million for the first half of fiscal year 2007, compared to $17 million for the same period in fiscal year 2006. We also invested $11 million in dpiX Holding for the construction of a manufacturing facility in Colorado in the first half of fiscal year 2007, compared to $3 million in the same period in fiscal year 2006. In the second quarter of fiscal year 2007, we used $27 million to acquire ACCEL.

Financing activities used net cash of $129 million in the first six months of fiscal year 2007 compared to $36 million in the first six months of fiscal year 2006. In the first half of fiscal year 2007, we used $153 million for the repurchases of common stock and $12 million to repurchase the 35% ownership interest in our Japanese subsidiary from Mitsubishi Electric Co. These uses were partially offset by cash proceeds of $24 million from employee stock option exercises and employee stock purchases and $13 million in excess tax benefits from share-based compensation. During the first half of fiscal year 2006, we used $124 million for the repurchase of common stock and $8 million (the value of withheld shares) for employees taxes due when restricted performance share awards vested. These uses were partially offset by cash proceeds of $53 million from employee stock option exercises and employee stock purchases and $43 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, will be approximately 4% of revenues in fiscal year 2007.

Our liquidity is affected by many factors, some of which result from the normal ongoing operations of our business and some of which arise from uncertainties and conditions in the United States and global economies. Although our cash requirements will fluctuate as a result of the shifting influences of these factors, we believe that existing cash and cash equivalents and cash to be generated from operations will be sufficient to satisfy anticipated commitments for capital expenditures and other cash requirements through fiscal year 2007. We currently anticipate that we will continue to utilize our strong liquidity and cash flows from operations to repurchase our common stock, make strategic acquisitions, invest in the growth of our business and invest in systems and processes.

Days Sales Outstanding

Trade accounts receivable days sales outstanding, or DSO, were 85 days at March 30, 2007, which was slightly higher than the 82 days at March 31, 2006 and was an improvement of 9 days from the DSO at 2006 fiscal year end of 94. Our accounts receivable and DSO are primarily impacted by timing of product shipments, collections performance, payment terms and mix of revenues from different regions.

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Stock Repurchase Program

On November 20, 2006, we announced that our Board of Directors had approved the repurchase of 4,500,000 shares of our common stock over the period through September 28, 2007 in addition to the 1,500,000 shares of common stock that had been available for repurchase as of September 29, 2006 under the prior program. During the six months ended March 30, 2007, we paid $153 million to repurchase 3,100,000 shares of VMS common stock, of which $76 million was paid during the three months ended March 30, 2007 to repurchase 1,600,000 shares. All shares that have been repurchased have been retired. As of March 30, 2007, we could repurchase up to 2,900,000 shares of our common stock under the November 20, 2006 authorization.

Contractual Obligations

There has been no significant change to the contractual obligations we reported in our Annual Report on Form 10-K for fiscal year 2006.

Total debt as a percentage of total capital decreased to 7.3% at March 30, 2007 from 8.0% at September 29, 2006. The ratio of current assets to current liabilities decreased to 1.7 to 1.0 at March 30, 2007 from 1.8 to 1.0 at September 29, 2006.

Contingencies

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

In addition, we may be required to incur significant additional costs to comply with future changes in existing environmental laws and regulations or new laws and regulations. For example, several countries, including many in the European Union, or EU, are requiring medical equipment manufacturers to bear some or all of the cost of product disposal at the end of a product useful life, thus creating increased costs for our operations. The EU has also adopted a directive that may require the adoption of restrictions on the use of some hazardous substances in certain of our products sold in the EU. This directive could increase costs for our operations.

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

As described below, we have accrued a total of $15.3 million as of March 30, 2007 to cover our liabilities for these cleanup projects.

Various uncertainties make it difficult to estimate the likelihood or cost of certain third-party claims, project management costs and legal costs at all of the sites and facilities. In addition, for the eight sites and one of the facilities, various uncertainties make it difficult to assess the likelihood and scope of further cleanup activities or to estimate the future costs of such activities. As of March 30, 2007, we nonetheless estimated that our future exposure (net of VI s and VSEA s indemnification obligations) for the cleanup costs, third-party claims, project management costs and legal costs for these nine locations ranged in the aggregate from $3.6 million to $7.2 million. The time frames over which these

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cleanup project costs are estimated vary, ranging from one year to 14 years as of March 30, 2007. We believe that no amount in the foregoing range of estimated future costs is more probable of being incurred than any other amount in such range and therefore accrued $3.6 million for these cleanup projects as of March 30, 2007. The amount accrued has not been discounted to present value due to the uncertainties that make it difficult to develop a best estimate of future costs.

As to all other facilities, we have gained sufficient knowledge to better estimate the scope and costs of future cleanup activities based upon formal agreements with other parties defining our future liabilities or formal cleanup plans that have either been approved by or completed in accordance with the requirements of the state or federal environmental agency with jurisdiction over the facility. As of March 30, 2007, we estimated that the our future exposure (net of VI s and VSEA s indemnification obligations) for the cleanup costs at these facilities, and reimbursements of third-party s claims for these facilities, ranged in the aggregate from $9.4 million to $36.0 million. The time frames over which these cleanup project costs are estimated vary with each facility, ranging from 2 years to 30 years as of March 30, 2007. As to each of these facilities, management determined that a particular amount within the range of estimated costs was a better estimate of the future environmental liability than any other amount within the range, and that the amount and timing of these future costs were reliably determinable. The best estimate within the range was $17.3 million at March 30, 2007. We accordingly accrued $11.7 million, which represents our best estimate of the future costs of $17.3 million discounted at 4%, net of inflation.

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

We receive certain cash payments in the form of settlements and judgments from defendants, our insurers and other third parties from time to time. We have also reached an agreement with an insurance company under which the insurance company has agreed to pay a portion of our past and future environmental-related expenditures, and we therefore had included a $2.8 million receivable at March 30, 2007, which was included in Other assets . We believe that this receivable is recoverable because it is based on a binding, written settlement agreement with a solvent and financially viable insurance company and the insurance company has in the past paid the claims that we have made.

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

We are also involved, from time to time, in other legal proceedings, claims and government inspections or investigations, arising in the ordinary course of our business. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. We accrue amounts 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 there can be no assurances 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 such an impact.

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 patent, copyright or any other intellectual property infringement claims by any third parties with respect to our products. The term of these indemnification arrangements is generally perpetual. The maximum potential amount of future payments we could be required to make under these agreements is unlimited. As of March 30, 2007, we have not incurred any significant costs since the spin-offs to defend lawsuits or settle claims related to these indemnification arrangements.

We have entered into indemnification agreements with our directors and officers that may require us to indemnify our directors and officers 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.

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Generally, the maximum obligation under such indemnifications is not explicitly stated and, as a result, the overall amount of these obligations cannot be reasonably estimated.

Recent Accounting Pronouncements

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109,* or SFAS 109. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS 109. This interpretation will be effective for us in the first quarter of fiscal year 2008. We are evaluating the impact of the adoption of this interpretation on our consolidated financial position, results of operations and cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements,* or SFAS 157. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently assessing the impact that SFAS 157 may have on our consolidated financial position, results of operations and cash flows.

In September 2006, the FASB issued SFAS No. 158, *Employer s Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R),* or SFAS 158. SFAS 158 requires us to (a) recognize a plan s funded status in its statement of financial position, (b) measure a plan s assets and its obligations that determine the plan s funded status as of the end of the employer s fiscal year and (c) recognize changes in the funded status of a defined postretirement plan in the year in which the changes occur through other comprehensive income. The requirement to recognize the funded status of a defined benefit plan and the disclosure requirements are effective for our fiscal year ending September 28, 2007. Based on the funded status of our plan obligations disclosed in Note 9 of the Notes to the Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended September 29, 2006, the estimated impact of adopting SFAS 158 would have been a decrease in total assets at September 29, 2006 of approximately $3 million, an increase in total liabilities of approximately $18 million and a reduction in stockholders equity of approximately $21 million, excluding the impact of taxes. There would have been no impact on our fiscal year 2006 Consolidated Statements of Earnings or Cash Flows. The actual impact of the implementation of SFAS 158 on the fiscal year 2007 financial statements will differ from that estimate due to changes in economic assumptions such as discount rates, measurement of fair values of plan assets, and other changes in actuarial assumptions that will occur in connection with the next measurement date on September 28, 2007.

In September 2006, the SEC issued SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements,* or SAB 108, to address diversity in practice in quantifying financial statement misstatements. SAB 108 requires the quantification of misstatements based on their impact on both the balance sheet and the income statement to determine materiality. The guidance provides for a one-time cumulative effect adjustment to correct for misstatements that were not deemed material under a company s prior approach but are material under the SAB 108 approach. SAB 108 will be effective for our fourth quarter of the fiscal year ending September 28, 2007. We are assessing the potential impact that SAB 108 may have on our consolidated financial position, results of operations and cash flows. However, based on the evaluation to date, we believe there will be no impact at adoption on our financial statements or related disclosures.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities -Including an Amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 is effective for us beginning in the first quarter of 2009. We are currently assessing the impact SFAS 159 may have on our consolidated financial position, results of operations and cash flows.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

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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 and Australia.

We have significant transactions denominated in foreign currencies and address certain financial exposures through a program of risk management that includes the use of derivative financial instruments. We sell products throughout the world, often in the currency of the customer s country, and typically hedge many of these firmly committed foreign currency denominated sales orders. These firmly committed foreign currency sales orders, excluding the amounts relating to the products made outside of the United States, are hedged with forward exchange contracts. We enter into foreign currency forward exchange contracts primarily to reduce the effects of fluctuating foreign currency exchange rates. We do not enter into forward exchange contracts for speculative or trading purposes. The forward exchange contracts range from one to twelve months in maturity. As of March 30, 2007, we did not have any forward exchange contracts with an original maturity greater than twelve months. As international deliveries may extend beyond twelve months, we may hedge beyond twelve months in the future.

We also hedge the balance sheet exposures from our various foreign subsidiaries and business units. We enter into monthly foreign currency forward exchange 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 value of sold forward exchange contracts for both hedges of foreign currency denominated sales orders and balance sheet exposures from our subsidiaries outstanding as of March 30, 2007 totaled $455.0 million. The notional value of purchased forward exchange contracts for both hedges of foreign currency denominated sales orders and balance sheet exposures from our subsidiaries outstanding as of March 30, 2007 totaled $28.6 million. The notional amounts of forward exchange contracts are not a measure of our exposure. The fair value of forward exchange contracts generally reflects the estimated amounts that we would receive or pay to terminate the contracts at the reporting date, thereby taking into account and approximating the current unrealized and realized gains or losses of the open contracts. A move in foreign currency exchange rates would change the fair value of the contracts, and the fair value of the underlying exposures hedged by the contracts would change in a similar offsetting manner.

Interest Rate Risk

Our market risk exposure to changes in interest rates depends primarily on our investment portfolio. Currently, our investment portfolio consists of cash and cash equivalents. In the unlikely event that interest rates were to decrease substantially, we might reinvest a substantial portion of our investment portfolio at lower interest rates. We would consider additional debt obligations to support general corporate purposes, including working capital requirements, capital expenditures and acquisitions. To date, we have not used derivative financial instruments to hedge the interest rate in our investment portfolio or long-term debt, but may consider the use of derivative instruments in the future.

The principal amount of cash, cash equivalents at March 30, 2007 totaled $289 million with a weighted average interest rate of 4.38% and an estimated average tax equivalent yield of 4.38%. We did not have any marketable securities at March 30, 2007. Our debt of $63.9 million at March 30, 2007 carried a weighted average fixed interest rate of 6.97% with principal payments due in various installments over a seven-year period.

The estimated fair value of our cash and cash equivalents and marketable securities (73% of which was held abroad at March 30, 2007 and could be subject to additional taxation if it were repatriated to the United States) 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

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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 second quarter of fiscal year 2007 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 8 of the Notes to the Condensed Consolidated Financial Statements under the caption Contingencies and in Management s Discussion and Analysis of Financial Condition and Results of Operations under the same caption, and such 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 should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we presently deem less significant may also impair our business operations. If any of the following risks actually occur, our business, operating results, and financial condition could be materially adversely affected.

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

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

We believe that IMRT has become a well-accepted standard of treatment in the radiation oncology market; however, if future studies contradict current knowledge about IMRT or call into question the effectiveness of our products or show negative side effects, or if other more effective technologies are introduced, our revenues could fail to increase or could decrease. Our success will depend upon the continued growth in awareness, acceptance and success of IMRT in general and acceptance of our products utilizing this technology in particular. IMRT drove high order and revenue growth in North America from 1999 to 2003. However, as more institutions purchase IMRT-equipped linear accelerators or upgrade their existing accelerators with IMRT technology, the market for IMRT-related products may become saturated and we would face competition from newer technologies. We have seen and continue to expect that the rate of growth for IMRT-related equipment will be lower than what we have experienced previously, particularly in the North American market, as over 50% of our customer sites worldwide have the products and accessories necessary to perform the most advanced forms of IMRT. Our future success, therefore, will depend on our ability to accurately anticipate and capitalize on new customer demands through technological innovations and changes, including new technologies for treatment such as IGRT.

IGRT is the most advanced radiation therapy technology that complements IMRT to further enhance radiation therapy treatments, and we continue to invest in product development relating to IGRT treatment capabilities. We are seeing customers accept IGRT as the next significant enhancement in curative radiation therapy, and demand for of our products for IGRT has been as one of the main contributors to net orders and revenue growth in our Oncology Systems business segment. Our future success will depend upon the wide-spread awareness, acceptance and adoption by the radiation oncology market of IGRT and our IGRT products as an evolutionary technology and methodology for radiotherapy treatment of cancers. We believe hospitals and clinics are converting to this new clinical process as early IGRT sites demonstrate the efficiency and effectiveness of IGRT. Our efforts to increase awareness and adoption of our IGRT products may not be successful. If our assumptions regarding the future importance of IGRT are incorrect, if IGRT fails to be effective as a treatment methodology, or if IGRT fails to become widely accepted, our orders and revenues could fail to increase or could decrease.

In January 2007, we completed the acquisition of ACCEL Instruments GmbH, or ACCEL, a privately-held supplier of scientific research instruments and proton therapy systems for cancer treatment. The acquisition will enable us to offer products for delivering image-guided, intensity-modulated proton therapy for certain cancer patients. While we intend to continue to invest in product development relating to proton therapy treatment capabilities, acceptance of this technology may be slower than with our other cancer treatment technologies due to the relatively large scale and higher costs associated with implementing a proton therapy system. Our future success will depend upon the

wide-spread awareness, acceptance and

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adoption by the oncology market of proton and particle therapy systems for treatment of certain cancers. Our efforts to increase awareness and adoption of our proton therapy systems may not be successful. If proton and particle therapy fail to be effective as treatment methodologies, or if proton and particle therapy fail to become widely accepted, our orders and revenues may not materialize.

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

Our X-ray Products business segment sells products primarily to a limited number of OEM customers who incorporate our products into their diagnostic imaging systems. Some of these companies also manufacture X-ray tubes or flat panel detectors for their own systems. We, therefore, compete with these in-house X-ray tube and flat panel detector manufacturing operations for business from their affiliated systems businesses. To succeed, we must provide X-ray tube and flat panel detector products that meet our customer demands for lower cost, better product quality and/or superior technology and performance. If we are unable to continue to innovate our X-ray Products technology and anticipate our customers demands in the areas of cost, quality, technology and performance, then our revenues could fail to increase or could decrease as our customers purchase from their internal manufacturing operations or from other independent X-ray tube or flat panel detector manufacturers.

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

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

Our success depends upon the successful development, introduction and commercialization of new generations of products, treatment systems and enhancements to and/or simplification of existing products. Our Oncology Systems products are technologically complex and must keep pace with, among other things, new product introductions of our competitors. Our X-ray Products business segment must also continually innovate to develop products with lower cost, better product quality and superior technology and performance. Accordingly, many of our products require significant planning, design, development and testing at the technological, product and manufacturing process levels. These activities require significant capital commitments, involvement of our senior management and other investments on our part, which we may be unable to recover. Our timeline for the development of new products or enhancements may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of new products or enhancements. In addition, a few of our research and development projects are funded by government contracts. Changes in government priorities and our ability to attract similar funding may affect our overall research effort and ultimately, our ability to develop successful new products and product enhancements.

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

- properly identify customer needs;
- prove feasibility of new products;
- limit the time required from proof of feasibility to routine production;
- comply with internal quality assurance systems and processes timely and efficiently;
- limit the timing and cost of regulatory approvals;
- accurately predict and control costs associated with inventory overruns caused by phase-in of new products and phase-out of old products;
- price our products competitively;
- manufacture and deliver our products in sufficient volumes on time, and accurately predict and control costs associated with manufacturing, installation, warranty and maintenance of the products;
- manage customer acceptance and payment for products;
- manage customer demands for retrofits of both new and old products; and
- anticipate and compete successfully with competitors efforts.

Additionally, our ability to gain healthcare market acceptance and demand for our new Oncology Systems products and treatment procedures may be also affected by the budgeting cycles of hospitals and clinics for capital equipment purchases, which frequently fix budgets one or more years in advance. In addition, even if customers accept new products or product enhancements, the revenues from these products may not be sufficient to offset the significant costs associated with making them available to customers or we may have longer sales and ordering timeframes due to customer budgeting cycles.

We cannot be sure that we will be able to successfully develop, manufacture or phase in new products, treatment systems or product enhancements. The roll-out of new products, systems and product enhancements involves compliance with complex quality assurance processes, including the Quality System Regulation, or QSR, of the U.S. Food and Drug Administration, or the FDA. Failure to complete these processes timely and efficiently could result in delayed introduction of new products, systems and product enhancements. Without the successful introduction of new products, systems and product enhancements, we may be unable to attract and retain customers, causing our revenues and operating results to suffer. Additionally, if we fail to successfully manage the transition from old products to new products, systems and product enhancements, our customers may delay or cancel orders, which would adversely affect our revenues and operating results.

In addition, the installation times associated with new products generally are longer than with well-established products. Because recognition of a portion of the revenue associated with new products is generally tied to installation and acceptance of the product, our recognition of revenue associated with new products may be deferred longer than expected. While we are working to decrease the installation times associated with new products, we cannot assure you that these plans will be successful or have a meaningful impact on reducing the associated revenue recognition deferrals. Furthermore, even if our plans to decrease installation times are successful, potential customers may not decide to upgrade their equipment. As a result, our revenues may be adversely impacted over a longer period of time, and our financial results could be adversely affected.

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

We conduct business globally. Our international revenues accounted for approximately 50% and 51% of revenues during the second quarter of fiscal years 2007 and 2006, respectively. As a result, we must provide significant service and support on a worldwide basis, and we have sales and service offices located throughout Europe, Asia, Latin America and Australia. In addition, we have manufacturing and research operations in England, Germany, Switzerland, France and Finland, and are building a manufacturing facility in China. We have invested and will continue to invest substantial financial and

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management resources to develop an international infrastructure to meet the needs of our customers. We intend to continue to expand our presence in international markets, although we cannot be sure we will be able to compete successfully in the international markets or meet the service and support needs of our customers there. Accordingly, our future results could be harmed by a variety of factors, including:

- the difficulties in enforcing agreements and collecting receivables through many foreign country s legal systems;
- the longer payment cycles associated with many foreign customers;
- the possibility that foreign countries may impose additional withholding taxes or otherwise tax our foreign income, impose tariffs or adopt other restrictions on foreign trade;
- the fact that international regions typically have a longer period from shipment to revenue recognition resulting in greater revenue recognition deferrals, higher backlog and a lower gross margin on our products;
- our ability to obtain U.S. export licenses and other required export or import licenses or approvals;
- failure to comply with U.S. 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;
- 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.

Also, historically, our international sales have had lower average selling prices and gross margins. So, as the geographic distribution of our orders and sales shifts increasingly towards our international regions, our overall rate of orders growth (measured in U.S. dollars) could slow down and overall revenues and gross margins may be negatively affected.

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

Since we sell our products internationally and have international operations, we are also subject to market risk due to fluctuations in foreign currency exchange rates, which may affect product demand, our expenses and/or the profitability in U.S. dollars of products and services provided by us in foreign markets where payment for our products and services or of our expenses is made in the local currency. We manage this risk through established policies and procedures that include the use of derivative financial instruments. We have historically entered into foreign currency forward exchange contracts to mitigate the effects of operational (sales orders) and balance sheet exposures to fluctuations in foreign currency exchange rates. Our forward exchange contracts generally range from one to twelve months in maturity.

Although we engage in hedging strategies that may offset the effect of fluctuations in foreign currency exchange rates, the protection these strategies provide will be affected by the timing of transactions, the effectiveness of the hedges (measured by how closely the changes in fair value of the hedging instrument offset the changes in fair value of the hedged item), the number of transactions that are hedged, forecast volatility and the extent of movement of foreign currency exchange rates. If our hedging strategies are not effective in offsetting the effect of fluctuations in foreign currency exchange rates, our operating results may be harmed. In addition, because currencies fluctuate and we engage in hedging strategies over time, movement in foreign currency exchange rates could impact our financial results positively or negatively in one period and not another, and therefore make comparing our financial results from period to period more difficult. Also because our hedging strategy is to protect the gross margin dollars on our orders, currency exchange rate fluctuations that positively affect our revenue dollars may result in erosion of gross margin percentages.

In addition, long-term movements in foreign currency exchange rates could affect the competitiveness of our products. Even though sales of our products internationally occur predominantly in local currencies, our cost structure is weighted towards the U.S. dollar, and some of our competitors may have cost structures based in other currencies, so our overall margins and pricing competitiveness may be adversely affected. In fact, in the recent past, we have benefited from the relatively weak U.S. dollar that has made our pricing more competitive with our foreign competitors. This has been a contributor to our international order and revenue growth. Any significant strengthening of the U.S. dollar against other countries currencies may result in slower growth in our international orders and revenues, which then could negatively affect our overall financial performance and results. The relative weakness of the U.S. dollar against other currencies has been a subject of policy discussions within the U.S. government and among other countries governments. Changes in monetary or other policies will likely affect foreign currency exchange rates.

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

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

In the United States, as a manufacturer and seller of medical devices and devices utilizing radioactive by-product material, we and some of our suppliers and distributors are subject to extensive regulation by the FDA and state and local regulatory agencies, such as the State of California, to ensure the devices are safe and effective. These regulations govern, among other things, the design, development, testing, manufacturing, packaging, labeling, distribution, import/export, sale and marketing of our products.

Unless an exception applies, the FDA requires that medical devices receive 510(k) pre-market clearance or pre-market approval before we, as a manufacturer of medical devices, can take orders for or sell those products in the United States. In addition, modifications or enhancements to these products that could significantly affect safety or effectiveness, or that constitute a major change in intended use, require further FDA clearance or approval. Obtaining FDA clearances or approvals is time-consuming, expensive and uncertain. We may fail to obtain the necessary clearances or approvals or may be unduly delayed in doing so. Furthermore, even if we are granted regulatory clearances or approvals, they may include significant limitations on the indicated uses of the product, which may limit the market for those products. If we were unable to obtain required FDA approval or clearance for a product, or were limited or unduly delayed in doing so, our business would suffer. In the past, our products have either been subject to 510(k) clearance or exempt from 510(k) clearance. The 510(k) clearance process is generally less time-consuming, expensive and uncertain than the pre-market approval, or PMA, process. If we were required to use the PMA approval process for future products or product modifications, it could delay or prevent release of the proposed products or modifications, and could cause our business to suffer.

Our manufacturing operations are required to comply with the FDA s QSR, which addresses the design, controls, methods, facilities and quality assurance used in manufacturing, assembly, packing, storing and installing medical devices. The FDA makes announced and unannounced inspections to determine compliance with QSR and in connection with these inspections has issued and in the future may issue reports or written notices listing instances where we have failed to comply with applicable regulations and/or procedures or may issue 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 timely respond to a Warning Letter or notice of noncompliance and to come into compliance could result in the FDA bringing enforcement action against us, which could include the 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 business and stock price.

The FDA also regulates the promotion and advertising for our products to ensure that the claims we make are consistent with our regulatory clearances, and that there is scientific data to substantiate the claims. If the FDA determines that any of our promotional claims are not permissible, we may be required to revise our promotional claims or may be subject to enforcement actions.

Our medical devices utilizing radioactive material are subject to the Nuclear Regulatory Commission, or NRC, clearance and approval requirements, and the manufacture and sale of these products are subject to extensive state regulation that varies from state to state. Our manufacture and distribution of medical devices utilizing radioactive material 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. We are also 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.

As a participant in the healthcare industry, we are also subject to extensive laws and regulations protecting the privacy and integrity of patient medical information, including the Health Insurance Portability and Accountability Act of 1996, or HIPAA, fraud and abuse laws and regulations such as physician self-referral prohibitions, anti-kickback laws and false claims laws. We also must comply with numerous federal, state and local laws of more general applicability relating to such matters as safe working conditions, manufacturing practices and fire hazard control.

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If we or any of our suppliers or distributors fail to comply with FDA and other applicable regulatory requirements or are perceived to potentially have failed to comply, it can result in a wide variety of actions, such as:

- adverse publicity affecting both us and our customers;
- increased pressures from our competitors;
- investigations, notices of non-compliance or Warning Letters;
- fines, injunctions, and civil penalties;
- partial suspensions or total shutdown of production facilities, or the imposition of operating restrictions;
- increased difficulty in obtaining required FDA clearances or approvals;
- losses of clearances or approvals already granted, or the refusal of future requests for clearance or approval;
- seizures or recalls of our products;
- delays in purchasing decisions by customers;
- the inability to sell our products; and
- criminal prosecutions.

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.

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

Our operations and sales of our products outside the United States are subject to regulatory requirements that vary from country to country, and may differ significantly from those in the United States. In general, our products are regulated outside the United States as medical devices by foreign governmental agencies similar to the FDA. We are also subject to laws and regulations outside the United States applicable to manufacturers of radiation producing devices and products utilizing radioactive materials, and laws and regulations of general applicability relating to matters such as environmental protection, safe working conditions, manufacturing practices and other matters, in each case that are often comparable, if not more stringent, than regulation in the United States. Our sales of products in foreign countries are also subject to regulation of matters such as product standards, packaging requirements, labeling requirements, environmental and product recycling requirements, import restrictions, tariff regulations, duties and tax requirements. In some countries, we rely on our foreign distributors to assist us in complying with foreign regulatory requirements. We may be required to incur significant time and expense in obtaining and maintaining regulatory approvals. Delays in receipt of or failure to receive regulatory approvals, the loss of previously obtained approvals or failure to comply with existing or future regulatory requirements could restrict or prevent us from doing business in the applicable country or subject us to

a variety of enforcement actions, which would adversely affect our business.

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

Our business exposes us to potential product liability claims that are inherent in the manufacture, sale, installation, servicing and support of medical devices and other devices that deliver radiation. Because our products are involved in the intentional delivery of radiation to the human body, other situations where people may come in contact with radiation (for example, when our SIP products are being used to scan cargo), the collection and storage of patient treatment data for medical purposes, the planning of radiation treatment and diagnostic imaging of the human body, and the diagnosing of medical problems, the possibility for significant injury and/or death exists. Our medical products are used as part of an overall process that takes place within our customers facilities and network systems, and under quality assurance, or QA, procedures established by the facility that ultimately result in the delivery of radiation to patients. As a result, we may face substantial liability to patients, our customers or others for damages resulting from the faulty or allegedly faulty design, manufacture, installation, servicing, support or the misuse of our products. We may also be subject to claims for property damages or

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economic loss related to or resulting from any errors or defects in our products, or the installation, servicing and support of our products. Additionally, errors or accidents in treatment may arise from the fact that our products operate in complex environments with products from other vendors, where interoperability or data sharing protocol may not be optimized. In any accident case, we could be subject to legal costs, adverse publicity and damage to our reputation, whether or not our products or services were a factor. Furthermore, adverse publicity regarding accidents or mistreatments involving radiation therapy could adversely impact our business by negatively affecting the reputation of radiation therapy in general, causing patients to question the efficacy of radiation therapy as a viable treatment for cancer and seek other modalities of treatment.

In addition, if a product we designed or manufactured were defective (whether due to design, labeling or manufacturing defects, improper use of the product or other reasons), we may be required to recall the product and notify regulatory authorities. Product recalls may also result in unexpected loss accruals under generally accepted accounting principles in the United States of America, or GAAP that may cause our quarterly results to fluctuate. The adverse publicity resulting from any of these actions could cause customers to review and potentially terminate their relationships with us. These recalls, especially if accompanied by unfavorable publicity or termination of customer contracts, could result in our incurring substantial costs and management time, losing revenues and damaging our reputation, each of which would harm our business.

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

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

The markets for radiation therapy equipment and software are characterized by rapidly evolving technology, intense competition and pricing pressure. Many of the companies with which our Oncology Systems business competes have greater financial, marketing and other resources than we have. Also, we expect that the rapid technological changes occurring in our markets will lead to the entry of new competitors into our markets, as well as our encountering new competitors as we apply our technologies in new markets such as stereotactic radiosurgery for neurosurgical and extracranial treatments. Our ability to compete successfully depends, in part, on our ability to provide technologically superior, clinically proven products that deliver more precise, cost-effective, high quality clinical outcomes, together in a complete package of products and services, and to do so ahead of our competitors. Our ability to compete in the radiation therapy market may be adversely affected when purchase decisions are based solely upon price, because our products are generally sold on a total value to the customer basis. This may occur if hospitals and clinics give purchasing decision authority to group purchasing organizations that focus solely on pricing as the primary determinant in making purchase decisions. In addition, the presence of additional competitors may delay customer purchasing decisions as customers evaluate the products of these competitors along with ours. These delays can extend our sales cycle and therefore adversely affect our net orders and related operating results. In our sales of linear accelerator products for radiotherapy and radiosurgery, we compete primarily with Siemens Medical Solutions, Elekta AB, Tomotherapy Incorporated and Accuray Incorporated. We compete with a variety of companies, such as Elekta AB, Philips Medical Systems, Computerized Medical Systems, Inc., North American Scientific, Inc., Nucletron B.V. and Siemens Medical Solutions in our software products, treatment simulation and verification products and accessories product lines. We also have begun to encounter some competition from providers of hospital information systems. In respect of our BrachyTherapy business, our primary competitor is Nucletron B.V. For the service and maintenance business for our products, we compete with independent service organizations and our customers internal service organizations.

The market for X-ray imaging components and subsystems is extremely competitive, with our competitors frequently having greater financial, marketing and other resources than we have. Some of the major diagnostic imaging systems companies, which are the primary OEMs for our X-ray tubes, also manufacture X-ray tubes for use in their own imaging systems products. We must compete with these in-house manufacturing operations that are naturally favored by their affiliated companies. As a result, we must have a competitive advantage in one or more significant areas, which may include lower product cost, better product quality or superior technology and performance. We sell a significant volume of our X-ray tubes to OEMs such as Toshiba Corporation, Hitachi Medical Corporation, Shimadzu Corporation, Philips Medical Systems and GE, all of which have in-house X-ray tube production capability. In addition, we compete against other stand-alone X-ray

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tube manufacturers such as Comet AG and IAE Industria Applicazioni Elettroniche Spa. These companies compete with us in both the OEM business and the independent servicing business for X-ray tubes. The market for flat panel detectors is also very competitive, and we primarily compete against GE, Trixell S.A.S., Canon, Inc. and Hologic, Inc. in our flat panel detector product line.

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

The market for proton and particle therapy products is characterized by rapidly evolving technology, high competition and pricing pressure. Our ability to compete successfully depends, in part, on our ability to provide technologically superior, clinically proven products that deliver more precise, cost-effective, high quality clinical outcomes. The presence of competitors may delay customer purchasing decisions as customers evaluate the products of these competitors along with ours. In the proton and particle therapy market, we compete principally with Ion Beam Applications S.A., Hitachi Medical Corporation and Still River, Inc. In the scientific instruments market, we compete with other companies as well as the internal engineering and fabrication capabilities in national and international research laboratories. Our competitors in this market include Thales Group, Mitsubishi Electric Corporation, Advanced Energy Systems, Inc. and Ettore Zanon SpA for our RF cavities and linear accelerators; ASG Superconductors SpA, Babcock Noell GmbH, Danfysik AS and Cryogenics Ltd. for our magnet systems, and Oxford Danfysik Beamlines Limited, Kohzu Precision Co., Ltd. and Instrument Design Technology Ltd. for our X-ray beamlines.

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

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

As radiation therapy becomes more and more complex, our customers are increasingly concerned about the interoperability and compatibility of the various products they use in providing treatment to patients. For example, our linear accelerators, treatment simulators, treatment verification products, treatment planning and information management software products are designed to interoperate with one another, and to be compatible with other widely used third-party radiation oncology products. Obtaining and maintaining this interoperability and compatibility is costly and time-consuming. When third parties modify the design or functionality of their products, it can require us to modify our products to ensure compatibility. Conversely, when we implement design improvements to our products, customers may be reluctant to adopt our new technology due to interoperability issues; for example, a clinic may be unwilling to implement new VMS technology because its third-party software network provider does not yet have a proper software interface available. In addition, our ability to obtain compatibility with third-party products can depend on the third parties providing us with adequate information regarding their products. In many cases, these third parties are our competitors and may time their product changes, and their sharing of relevant information with us, to place us at a competitive disadvantage. Further, we could be required to obtain additional regulatory clearances for any modification of our products due to interoperability issues with the products of third parties. It is also possible that, despite our best efforts, we may be unable to make our products interoperable or compatible with widely used third-party products or may only be able to do so at a prohibitive expense, making our products less attractive or more costly to our customers.

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

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

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

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

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

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

We obtain some of the components and subassemblies included in our products from a limited group of suppliers, or in some cases a single-source supplier. Examples include the source wires for high-dose afterloaders; klystrons for linear accelerators; imaging panels; non-coated array sensors; coating for array sensors for the flat panel detectors; specialized integrated circuits for imaging subassemblies; and some targets, housings and glass bulbs for X-ray tubes. If we lose any of these suppliers, 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 would likely cause material delays in delivery and could significantly increase costs for the affected product. Although we have obtained limited insurance to protect against business interruption loss, we cannot assure you that this insurance coverage

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will be adequate or that it will continue to remain available on acceptable terms, if at all. Additionally, some of these suppliers, including our single-source suppliers, supply components in rapidly growing product lines. Manufacturing capacity limitations of any of these suppliers or the inability of these suppliers to be able to meet increasing demand are also possibilities that could adversely affect us, resulting in curtailed growth opportunities for any of our product lines and higher costs of manufacturing for us as prices increase for these components and subassemblies due to shortage and greater demand. 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.

WE SELL OUR X-RAY TUBES TO A LIMITED NUMBER OF OEM CUSTOMERS, MANY OF WHOM ARE ALSO OUR COMPETITORS, AND THE LOSS OR REDUCTION IN PURCHASING VOLUME BY ONE OR MORE OF THESE CUSTOMERS OR CONSOLIDATION AMONG OEMs IN THE X-RAY TUBE PRODUCTS MARKET COULD REDUCE OUR SALES OF X-RAY TUBE PRODUCTS

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

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

Our SIP business designs, manufactures, sells and services Linatron X-ray accelerators for security and inspection purposes. We generally sell our accelerators to OEMs who incorporate them into their inspection products, which are then sold to customs agencies and other government agencies, as well as to commercial private parties. We believe growth in this 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 technology in security cargo screening and border protection is in its early stages. Orders for our security and inspections products have been and may continue to be unpredictable and the actual timing of sales and revenue recognition will vary significantly, as it is difficult to predict our OEM customer delivery and acceptance schedules.

In addition, our SIP business is heavily influenced by U.S. and foreign governmental policies on national and homeland security, border protection and customs revenue activities, all of which depend upon government budgets and appropriations that are subject to political changes. These influences are inherently unpredictable, and may cause uncertainty and variability in the timing of orders. Thus, orders in any quarter or period are not necessarily directly correlated to the level of sales or revenues in any particular future quarter or period. This unpredictability in orders, sales and revenue timing could cause volatility in our revenues and earnings, and therefore our stock price.

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 Oncology Systems and proton therapy products, we are often required to educate physicians about the use of a new treatment procedure such as IMRT, IGRT and 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 and proton therapy generally and to encourage acceptance and adoption of our products for IMRT, IGRT and proton therapy. The timing of our competitors introduction of products and the market acceptance of their products may also make this educational process more difficult. We cannot be

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sure that any products we develop will gain any significant market acceptance and market share among physicians, patients and healthcare payors, even if the required regulatory approvals are obtained.

WE MAY NOT BE ABLE TO MAINTAIN OR EXPAND OUR BUSINESS IF WE ARE NOT ABLE TO RETAIN, HIRE AND INTEGRATE SUFFICIENTLY QUALIFIED PERSONNEL

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

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

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

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

Our success will depend, in part, on our ability to expand our product offerings and grow our businesses in response to changing technologies, customer demands and competitive pressures. In some circumstances, as a strategy to achieve quicker time to market for new products or technology, or to enter new markets, we may determine to grow our business through the acquisition of complementary businesses, products or technologies rather than through internal development. For example, in the second quarter of fiscal year 2007, we acquired ACCEL, a privately held German supplier of scientific research instruments and proton therapy systems for cancer treatment. The identification of suitable acquisition candidates can be difficult, time-consuming and costly, and we may not be able to identify suitable candidates or successfully complete identified acquisitions. In addition, the completion of an acquisition could divert our management and key personnel from our business operations, which could harm our business and affect our financial results. Furthermore, even if we complete an acquisition, we may not be able to successfully integrate newly acquired organizations, products or technologies or employees into our operations, and the process of integration could be expensive, time-consuming and may strain our resources. In many instances, this will also involve implementing or improving internal controls appropriate for a public company at businesses that lack 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. Consequently, we may not achieve anticipated growth or other benefits from an acquisition, which could harm our existing business. In addition, future acquisitions could result in potentially dilutive issuances of equity securities or the incurrence of debt, contingent liabilities or expenses, or other charges such as in-process research and development, any of which could harm our business and affect our financial results.

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

From time to time, we may acquire or develop new lines of business, such as proton therapy. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. New risks include developing knowledge of and experience in new businesses, recruiting professionals to manage the new business lines, and developing and capitalizing on new marketing relationships with experienced market participants. Each new business may require the investment of additional capital and the significant involvement of our senior management to

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acquire or develop, then integrate, the new line of business into our operations. Initial timetables for the introduction and development of new lines of business may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business. Failure to successfully manage these risks in the development and implementation of new lines of business could materially and adversely affect our business, results of operations and financial condition.

WE UTILIZE DISTRIBUTORS FOR A PORTION OF OUR SALES, THE LOSS OF WHICH COULD HARM OUR REVENUES IN THE TERRITORY SERVICED BY THESE DISTRIBUTORS

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

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

The United States government has in the past, and may in the future, consider healthcare policies and proposals intended to curb rising healthcare costs, including those that could significantly affect both private and public reimbursement for healthcare services. State and local governments, as well as a number of foreign governments, are also considering or have adopted such policies. These policies have included, and may in the future include, rationing of government-funded reimbursement for healthcare services and imposing price controls on medical products and services providers. Future significant changes in the healthcare systems in the United States or elsewhere, including those that may reduce reimbursement rates for our products or procedures using our products, could have a negative impact on the demand for our products and services and our business. We are unable to predict what healthcare reform legislation or regulations, if any, will be enacted in the United States or elsewhere, whether other healthcare legislation or regulations affecting our business may be proposed or enacted in the future, or what effect any legislation or regulation would have on our business.

In addition, sales of some of our products indirectly depend on whether adequate reimbursement is available to our customers for the treatment provided by those products from third-party healthcare payors, such as government healthcare insurance programs, including the Medicare and Medicaid programs, private insurance plans, health maintenance organizations and preferred provider organizations. Once Medicare has made a decision to provide reimbursement for a given treatment, these reimbursement rates are generally reviewed and adjusted by Medicare annually. Private third-party payors often adopt Medicare reimbursement policies and payment amounts. As a result, decisions by the Centers for Medicare and Medicaid Services, or CMS, to reimburse for a treatment, or changes to Medicare s reimbursement policies or reductions in payment amounts with respect to a treatment would likely extend to third-party payor reimbursement policies and amounts for that treatment. While we believe reimbursement policies and amounts are not a major factor in our customer purchasing decisions for radiotherapy products, a dramatic change in the availability and amount of reimbursement for treatments using our products could influence our customers decisions. Any sharp cuts in overall reimbursement rates for radiotherapy, radiosurgery or brachytherapy could increase uncertainty and reduce demand for our products and have a material adverse effect on our revenues and stock price.

As a general matter, third-party payors are increasingly challenging the pricing of medical procedures or limiting or prohibiting reimbursement for specific services or devices, and we cannot be sure that they will reimburse our customers at levels sufficient to enable us to achieve or maintain sales and price levels for our products. Without adequate support from third-party payors, the market for our products may be limited. There is no uniform policy on reimbursement among third-party payors, nor can we be sure that procedures using our products will qualify for reimbursement from third-party payors. Foreign governments also have their own healthcare reimbursement systems, and there is an emerging private sector. We cannot be sure that adequate reimbursement will be made available with respect to our products under any foreign reimbursement system.

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

We have experienced and expect in the future to experience fluctuations in our operating results, including net orders, revenues and gross margins. Many of our products require significant capital expenditures by our customers. Accordingly, individual product orders can be quite large in dollar amounts, which can extend the customer purchasing cycle. We have

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experienced this with our IGRT products, and expect this to extend to our proton therapy and scientific instruments products because of the high cost of the equipment and the complexity of project financing. We also expect that orders for ACCEL scientific instruments products will vary as they are tied primarily to large, government or national laboratory research projects. In addition, some of our more sophisticated equipment, such as IGRT and proton therapy products, requires greater site preparation and longer construction cycles, which can delay installation and backlog conversion. For proton therapy products, this can delay the customer decision cycles even further. The timing of when individual orders are placed and the revenues recognized could have an effect our quarterly results. Timing of order placement from customers, including those in the government or public sector, and their willingness to commit to purchase products are inherently difficult to predict or forecast. Once orders are received, factors that may affect whether these orders become revenues and the timing include:

- delay in shipment due, for example, to longer construction projects or unanticipated construction delays at customer locations where our products are to be installed, cancellations or rescheduling by customers, extreme weather conditions, natural disasters, port strikes or manufacturing difficulties;
- delay in the installation and/or acceptance of a product; or
- a change in a customer s financial condition or ability to obtain financing.

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

- changes in our or our competitors pricing or discount levels;
- changes or anticipated changes in third-party reimbursement amounts or policies applicable to treatments using our products;
- revenues becoming affected by seasonal influences;
- timing of revenue recognition;
- changes in foreign currency exchange rates;
- changes in the relative portion of our revenues represented by our various products, including the relative mix between higher margin and lower margin products;
- changes in the relative portion of our revenues represented by the international region;
- timing of the announcement, introduction and delivery of new products or product enhancements by us and by our competitors;
- disruptions in the supply or changes in the costs of raw materials, labor, product components or transportation services;

changes in the general economic conditions in the regions in which we do business;

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

the impact of changing levels of sales to sole purchasers of certain of our X-ray products;

the unfavorable outcome of any litigation; and

accounting adjustments, such as those relating to accounting reserves for product recalls, share-based compensation expense as required under SFAS 123(R) and changes in interpretation of 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.

Oncology Systems gross margin in the second quarter of fiscal year 2007 improved slightly from the same period in fiscal year 2006 due principally to the improvement in service contracts gross margin partially offset by an a decrease in product gross margin. The decrease in product gross margin was primarily due to the effect of hedging foreign currency denominated sales contracts when the orders were booked. While the weakening of the U.S. dollar

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positively affected our revenues, it had a negative impact on our gross margin percentage. In addition, the decrease in product gross margin was due to a higher proportion of revenues associated with certain new products for IGRT, which are not yet at the gross margin level of other products. Our overall gross margin may also be impacted by the gross margin of our ACCEL 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 our common stock would almost certainly decline.

We report on a quarterly and annual basis our net orders and backlog. It is important to understand that, unlike revenues, net orders and backlog are not governed by the rules of GAAP, and are not within the scope of the audit or reviews conducted by our independent public accountants; therefore, investors should not interpret our net orders or backlog results in such a manner. Also, our net orders and backlog cannot necessarily be relied upon as accurate predictors of future revenues as the timing of future revenues depends on completion of customer site preparation and construction, installation scheduling, customer capital budgeting and financing, appropriate regulatory authorizations and other factors. Unexpected levels of cancellation of orders or delays in customer purchase decisions or delivery dates will reduce the quarterly net orders results 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 and revenues in one or more future periods may fall below the expectations of securities analysts and investors. In that event, the trading price of our common stock would almost certainly decline.

THE FINANCIAL RESULTS OF OUR ACCEL BUSINESS MAY FLUCTUATE AND BE UNPREDICTABLE

The proton therapy and scientific instruments projects of our ACCEL business are highly customized and vary in size and complexity. Planning for these projects will take more time and use more resources than those in our traditional radiotherapy business. In the proton therapy market, due to its relatively large scale, the construction of a proton therapy facility requires significant capital investment and may involve complex project financing. In the scientific instruments market, projects are generally publicly funded, and therefore decisions on new projects or project upgrades are subject to public and political factors. Therefore, sales and customer decision cycles may take several years. As a result, the timing of proton therapy and scientific instruments projects will vary significantly from period to period, and our operating results and stock price may be adversely affected.

In addition, many of the components used in proton therapy equipment require a long lead time, which may lead to an increase in our levels of inventory. This may cause fluctuations in the operating results of our ACCEL business that may make it difficult to predict our operating results and to compare our financial results from period to period. This could have an adverse effect on our stock price.

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

We prepare our financial statements to conform with GAAP. These principles are subject to interpretation by the Financial Accounting Standards Board, American Institute of Certified Public Accountants, the 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, as our operations evolve over time, we may introduce new products or new technologies that require us to apply different accounting principles, including those regarding revenue recognition, than we had applied in past periods. For example, if our products develop to contain more software components, we may be required to recognize revenue for the software components separately from the hardware components and in accordance with software revenue recognition rules, which could delay recognition of some revenue. Additionally, while for many of our Oncology Systems products we recognize revenue in accordance with Staff Accounting Bulletin No. 104 Revenue Recognition and SOP No. 97-2, *Software Revenue Recognition*, as amended by SOP No. 98-9, *Software Revenue Recognition with Respective to Certain Agreements*, for the newly acquired business of Accel Instruments GmbH, we plan to recognize revenues for certain contracts for proton therapy services and scientific instruments products using the percentage-of-completion method in accordance with SOP 81-1, *Accounting for Performance of Construction-Type and Certain Product Type Contracts*, which will affect the timing of revenue recognition. Changes in accounting principles may affect the timing of revenue recognition or make it more difficult to compare our financial results from quarter to quarter, and the trading price of our common stock could suffer or become more volatile as a result.

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WE ARE REQUIRED TO RECOGNIZE EXPENSE FOR SHARE-BASED COMPENSATION RELATED TO STOCK OPTIONS AND EMPLOYEE STOCK PURCHASES, AND WE CANNOT ASSURE YOU THAT THE EXPENSE THAT WE ARE REQUIRED TO RECOGNIZE ACCURATELY MEASURES THE VALUE OF OUR SHARE-BASED PAYMENT AWARDS, AND THE RECOGNITION OF THIS EXPENSE COULD CAUSE THE TRADING PRICE OF OUR COMMON STOCK TO DECLINE

On October 1, 2005, we adopted SFAS 123(R), which requires the measurement and recognition of compensation expense for all share-based payment awards made to our employees and VMS directors including stock options and employee stock purchases related to the Employee Stock Purchase Plan and restricted stock based on fair values. Prior to fiscal year 2006, the only share-based compensation expense we recognized was for restricted stock.

The application of SFAS 123(R) requires the use of an option-pricing model, such as the Black-Scholes option-pricing model, to determine the fair value of share-based payment awards. Option-pricing models were developed for use in estimating the value of traded options that have no vesting restrictions and are fully transferable. Our stock options and the option component of the Employee Stock Purchase Plan shares have characteristics significantly different from those of traded options, and changes in the assumptions (such as expected term, stock price volatility and other variables) can materially affect the fair value estimates. Therefore, although we determine the fair value of stock options and the option component of the Employee Stock Purchase Plan shares in accordance with SFAS 123(R) and Staff Accounting Bulletin 107, the existing valuation models may not provide an accurate measure of this fair value, and we cannot assure you that the resulting expense that we are required to recognize accurately measures that value.

As a result of the adoption of SFAS 123(R), our earnings in fiscal year 2006 and the first half of fiscal year 2007 were lower than they would have been had we not been required to adopt SFAS 123(R). This will continue to be the case for future periods. We cannot predict the effect that expensing share-based payments will have on the trading price of our common stock.

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

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

In addition, we may be required to incur significant additional costs to comply with future changes in existing environmental laws and regulations or new laws and regulations. For example, several countries, including many in the European Union, or EU, are requiring medical equipment manufacturers to bear some or all of the cost of product disposal at the end of the products useful life, thus creating increased costs for our operations. The EU has also adopted a directive that may require the adoption of restrictions on the use of some hazardous substances in certain of our products sold in the EU. This directive could create increased costs for our operations. All of these costs, and any future violations or liability under environmental laws or regulations, could have a material adverse effect on our business.

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

In light of the relatively low interest rates on our invested cash and in order to better utilize our cash position in a manner to better assist sales of our products, we offer longer or extended payment terms for qualified customers in some circumstances. During the second quarter of fiscal year 2007, revenues earned from customer contracts with longer or extended payment terms amounted to approximately 4% of total Oncology Systems revenues. While we qualify customers to whom we offer longer or extended payment terms, we cannot assure you that the financial positions of these customers will not change adversely over the longer time period given for payment. In such an event, we may experience an increase in payment defaults in our accounts receivable, which will affect our net earnings. Also, longer or extended payment terms has and may in the future result in an increase in our days sales outstanding.

OUR OPERATIONS ARE VULNERABLE TO INTERRUPTION OR LOSS DUE TO NATURAL DISASTERS, POWER LOSS, STRIKES AND OTHER EVENTS BEYOND OUR CONTROL, WHICH WOULD ADVERSELY AFFECT OUR BUSINESS

We conduct a significant portion of our activities including manufacturing, administration and data processing at facilities located in the State of California and other seismically active areas that have experienced major earthquakes in the past, as well as other natural disasters. We carry limited earthquake insurance. This coverage may not be adequate or continue to be available at commercially reasonable rates and terms. A major earthquake or other disaster affecting our facilities could significantly disrupt our operations, and delay or prevent product manufacture and shipment during the time required to repair, rebuild or replace our manufacturing facilities; these delays could be lengthy and result in large expenses. 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. In addition, our products are typically shipped from a limited number of ports, and any natural disaster, strike or other event blocking shipment from these ports could delay or prevent shipments and harm our business.

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

Concerns about terrorism or an outbreak of epidemic diseases such as Severe Acute Respiratory Syndrome and Avian Influenza, especially in our major markets of North America or Europe, could have a negative effect on travel and our business operations, and result in adverse consequences on our revenues and financial performance.

OUR STOCKHOLDER RIGHTS PLAN AND PROVISIONS OF OUR CERTIFICATE OF INCORPORATION MAY DISCOURAGE A TAKE-OVER AND THEREFORE LIMIT THE PRICE OF OUR COMMON STOCK

We have a stockholder rights plan that, under specific circumstances, would significantly dilute the equity interest in our company of a person (or persons) seeking to acquire control of our company without the prior approval of our Board of Directors. Our Certificate of Incorporation also includes provisions that may make an acquisition of control of our company without the approval of our Board of Directors more difficult. This stockholder rights plan and provisions in our Certificate of Incorporation may discourage take-over attempts and limit the price of our common stock.

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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 second quarter of fiscal year 2007.

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)
December 30, 2006 - January 26, 2007	527,447(2)	$ 48.36(2)	527,235	3,972,765
January 27, 2007 - February 23, 2007	692,856	$ 48.00	692,856	3,279,909
February 24, 2007 - March 30, 2007	379,909	$ 46.09	379,909	2,900,000
Total	1,600,212	$ 47.67	1,600,000	

(1) On November 21, 2005, we announced that our Board of Directors had authorized the repurchase of up to 6,000,000 shares of our common stock through December 31, 2006. This authorization expired on December 31, 2006, with all shares repurchased. On November 20, 2006, we announced that our Board of Directors had authorized the repurchase of up to an additional 4,500,000 shares of our common stock over the period prior to September 28, 2007. We expect repurchases will be made in accordance with Rule 10b-18 and include a plan designed to satisfy the Rule 10b5-1 safe harbor. Shares will be retired upon repurchase.

(2) Includes 212 shares of VMS common stock that were tendered to VMS for employees taxes withheld for vested restricted common stock.

Item 3. Defaults Upon Senior Securities

None.

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

At our Annual Meeting of Stockholders held on February 15, 2007 (the Stockholders Meeting), the stockholders of Varian Medical Systems, Inc. voted on the following four items and cast their votes as follows:

Proposal One:

To elect the following for three-year terms ending with the 2010 annual meeting of stockholders.

	For	Withheld	Broker Non-Votes(1)
John Seely Brown	113,363,902	1,791,322	N/A
R. Andrew Eckert	113,436,185	1,719,039	N/A
Mark R. Laret	113,499,527	1,655,697	N/A
Kent J. Thiry	113,525,757	1,629,467	N/A

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Directors Susan L. Bostrom, Timothy E. Guertin, Richard M. Levy, Allen S. Lichter, M.D., David W. Martin, Jr., M.D. and Ruediger Naumann-Etienne continued in office following the Stockholders Meeting.

Proposal Two:

To approve the adoption of the Varian Medical Systems, Inc. Second Amended and Restated 2005 Omnibus Stock Plan.

For	Against	Abstain	Broker Non-Votes
85,459,446	13,284,423	487,693	15,923,662

Proposal Three:

To approve the adoption of the Varian Medical Systems, Inc. Management Incentive Plan.

For	Against	Abstain	Broker Non-Votes[(1)]
110,770,505	3,692,386	692,333	N/A

Proposal Four:

To ratify the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for fiscal year 2007.

For	Against	Abstain	Broker Non-Votes[(1)]
113,403,780	1,584,285	167,159	N/A

(1) Pursuant to the rules of the New York Stock Exchange, this proposal constituted a routine matter. Therefore, brokers were permitted to vote without receipt of instructions from beneficial owners.

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
10.1	Registrant s Second Amended and Restated 2005 Omnibus Stock Plan.
10.2	Registrant s Management Incentive Plan.
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.

Management contract or compensatory arrangement.

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SIGNATURES

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

VARIAN MEDICAL SYSTEMS, INC.

(Registrant)

Dated: May 7, 2007

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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