

VARIAN MEDICAL SYSTEMS INC

Form 10-Q

February 09, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 10-Q

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☒ QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended January 1, 2016

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

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VARIAN MEDICAL SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

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Delaware	94-2359345
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

3100 Hansen Way, Palo Alto, California	94304-1038
(Address of principal executive offices)	(Zip Code)
(650) 493-4000	
(Registrant's telephone number, including area code)	

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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 ☒ No ☐

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

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

Large Accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
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Non-Accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>
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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 95,502,553 shares of common stock, par value \$1 per share, outstanding as of January 29, 2016.

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VARIAN MEDICAL SYSTEMS, INC.  
FORM 10-Q for the Quarter Ended January 1, 2016  
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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	
	January 1, 2016	January 2, 2015
(In thousands, except per share amounts)		
Revenues:		
Product	\$500,526	\$475,830
Service	256,607	262,024
Total revenues	757,133	737,854
Cost of revenues:		
Product	343,456	305,817
Service	103,985	105,029
Total cost of revenues	447,441	410,846
Gross margin	309,692	327,008
Operating expenses:		
Research and development	59,981	57,076
Selling, general and administrative	133,061	140,482
Total operating expenses	193,042	197,558
Operating earnings	116,650	129,450
Interest income	3,949	3,040
Interest expense	(2,230)	(2,045)
Earnings before taxes	118,369	130,445
Taxes on earnings	29,327	37,131
Net earnings	89,042	93,314
Less: Net earnings attributable to noncontrolling interests	15	—
Net earnings attributable to Varian	\$89,027	\$93,314
Net earnings per share - basic	\$0.92	\$0.93
Net earnings per share - diluted	\$0.91	\$0.92
Shares used in the calculation of net earnings per share:		
Weighted average shares outstanding - basic	97,156	100,468
Weighted average shares outstanding - diluted	97,843	101,642

See accompanying notes to the condensed consolidated financial statements.



VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS  
 (Unaudited)

	Three Months Ended	
(In thousands)	January 1, 2016	January 2, 2015
Net earnings	\$89,042	\$93,314
Other comprehensive earnings (loss), net of tax:		
Defined benefit pension and post-retirement plans:		
Amortization of prior service cost included in net periodic benefit cost, net of tax benefit of \$45 and \$41	(72	) (38
Amortization of net actuarial loss included in net periodic benefit cost, net of tax expense of (\$132) and (\$116)	601	504
	529	466
Derivative instruments:		
Change in unrealized gain (loss), net of tax expense of (\$54) and (\$284)	91	475
Reclassification adjustments, net of tax benefit of \$0 and \$326	—	(545
	91	(70
Available-for-sale securities:		
Change in unrealized gain (loss), net of tax benefit of \$141	(299	) —
Reclassification adjustments, net of tax expense of (\$193)	411	—
	112	—
Currency translation adjustment	(4,653	) (12,290
Other comprehensive loss	(3,921	) (11,894
Comprehensive earnings	85,121	81,420
Less: Comprehensive earnings attributable to noncontrolling interests	15	—
Comprehensive earnings attributable to Varian	\$85,106	\$81,420

See accompanying notes to the condensed consolidated financial statements.

VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Unaudited)

	January 1, 2016	October 2, 2015 (1)
(In thousands, except par values)		
Assets		
Current assets:		
Cash and cash equivalents	\$953,377	\$845,468
Accounts receivable, net of allowance for doubtful accounts of \$25,029 at January 1, 2016 and \$21,218 at October 2, 2015	768,548	770,920
Inventories	613,069	612,607
Prepaid expenses and other current assets	174,693	163,984
Deferred tax assets	130,529	132,066
Total current assets	2,640,216	2,525,045
Property, plant and equipment, net	372,858	379,215
Goodwill	281,773	283,452
Other assets	431,815	413,036
Total assets	\$3,726,662	\$3,600,748
Liabilities, Redeemable Noncontrolling Interests and Equity		
Current liabilities:		
Accounts payable	\$173,996	\$202,918
Accrued liabilities	352,711	353,500
Deferred revenues	502,871	489,775
Advance payments from customers	176,228	178,265
Short-term borrowings	333,249	108,446
Current maturities of long-term debt	50,000	50,000
Total current liabilities	1,589,055	1,382,904
Long-term debt and other borrowings	345,000	337,500
Other long-term liabilities	150,543	154,000
Total liabilities	2,084,598	1,874,404
Commitments and contingencies (Note 9)		
Redeemable noncontrolling interests	10,382	—
Equity:		
Varian 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; 95,999 and 98,070 shares issued and outstanding at January 1, 2016 and at October 2, 2015, respectively	95,999	98,070
Capital in excess of par value	659,865	682,167
Retained earnings	962,324	1,017,826
Accumulated other comprehensive loss	(90,384)	(86,463)
Total Varian stockholders' equity	1,627,804	1,711,600
Noncontrolling interests	3,878	14,744
Total equity	1,631,682	1,726,344
Total liabilities, redeemable noncontrolling interests and equity	\$3,726,662	\$3,600,748

(1) The condensed consolidated balance sheet as of October 2, 2015 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 condensed consolidated financial statements.



VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

	Three Months Ended	
	January 1, 2016	January 2, 2015
(In thousands)		
Cash flows from operating activities:		
Net earnings	\$89,042	\$93,314
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Share-based compensation expense	11,255	12,737
Tax benefits from exercises of share-based payment awards	1,044	6,264
Excess tax benefits from share-based compensation	(1,101)	(6,239)
Depreciation	15,483	15,424
Amortization of intangible assets	2,987	1,647
Deferred taxes	(3,223)	14,110
Provision for doubtful accounts receivable	3,997	7,901
Other, net	1,051	217
Changes in assets and liabilities:		
Accounts receivable	(29,461)	43,720
Inventories	(3,989)	(62,149)
Prepaid expenses and other assets	(11,956)	(8,035)
Accounts payable	(14,177)	(37,012)
Accrued liabilities and other long-term liabilities	5,288	(25,572)
Deferred revenues and advance payments from customers	10,982	22,625
Net cash provided by operating activities	77,222	78,952
Cash flows from investing activities:		
Purchases of property, plant and equipment	(27,308)	(21,723)
Investment in available-for-sale securities	(880)	(942)
Sale of available-for-sale securities	8,638	—
Notes receivable	(2,069)	(3,000)
Amounts paid to deferred compensation plan trust account	(2,725)	—
Other	84	87
Net cash used in investing activities	(24,260)	(25,578)
Cash flows from financing activities:		
Repurchases of common stock	(192,077)	(125,535)
Proceeds from issuance of common stock to employees	15,329	34,795
Excess tax benefits from share-based compensation	1,101	6,239
Employees' taxes withheld and paid for restricted stock and restricted stock units	(4,477)	(11,362)
Borrowings under credit facility agreement	75,000	—
Repayments under credit facility agreement	(67,500)	(12,500)
Net borrowings under credit facility agreements with maturities less than 90 days	225,000	100,000
Contingent consideration and hold back	(2,550)	(734)
Other	—	1,774
Net cash provided by (used in) financing activities	49,826	(7,323)
Effects of exchange rate changes on cash and cash equivalents	5,121	9,033
Net increase in cash and cash equivalents	107,909	55,084
Cash and cash equivalents at beginning of period	845,468	849,275
Cash and cash equivalents at end of period	\$953,377	\$904,359

See accompanying notes to the condensed consolidated financial statements.

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 its subsidiaries (collectively, the "Company") designs, manufactures, sells and services hardware and software products for treating cancer with radiotherapy, stereotactic radiosurgery, stereotactic body radiotherapy, and brachytherapy. The Company also designs, manufactures, sells and services X-ray imaging components for use in a range of applications, including radiographic or fluoroscopic imaging, mammography, special procedures, computed tomography, computer-aided diagnostics and industrial applications. In addition, the Company designs, manufactures, sells and services linear accelerators, image processing software and image detection products for security and inspection purposes. The Company also develops, designs, manufactures, sells and services proton therapy products and systems for cancer treatment.

Basis of Presentation

The condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP") have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements and the accompanying notes are unaudited and should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended October 2, 2015 (the "2015 Annual Report"). In the opinion of management, the condensed consolidated financial statements herein include adjustments (consisting only of normal recurring adjustments) necessary for a fair statement of the Company's financial position as of January 1, 2016 and October 2, 2015, results of operations and statements of comprehensive earnings for the three months ended January 1, 2016 and January 2, 2015, and cash flows for the three months ended January 1, 2016 and January 2, 2015. The results of operations for the three months ended January 1, 2016 are not necessarily indicative of the operating results to be expected for the full fiscal year or any future period.

Fiscal Year

The fiscal years of the Company as reported are the 52- or 53- week periods ending on the Friday nearest September 30. Fiscal year 2016 is the 52-week period ending September 30, 2016, and fiscal year 2015 was the 53-week period ended October 2, 2015. The fiscal quarter ended January 1, 2016 was a 13-week period and the fiscal quarter ended January 2, 2015 was a 14-week period.

Principles of Consolidation

The condensed consolidated financial statements include those of VMS and its wholly-owned and majority-owned or controlled subsidiaries. Intercompany balances, transactions and stock holdings have been eliminated in consolidation.

Use of Estimates

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

Recent Accounting Pronouncements or Updates Not Yet Effective

In January 2016, the Financial Accounting Standards Board ("FASB") issued an amendment to its accounting guidance related to recognition and measurement of financial assets and financial liabilities. The amendment addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The amendment will be effective for the Company beginning in its first quarter of fiscal year 2019. The Company is evaluating the impact of adopting this guidance to its consolidated financial statements.



VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

In November 2015, the FASB issued an amendment to its accounting guidance related to balance sheet classification of deferred taxes. The amendment requires that deferred tax liabilities and assets be classified as noncurrent in the statement of financial position. The amendment affects presentation only and will be effective for the Company beginning in its first quarter of fiscal year 2018. Early adoption is permitted. The amendment can be adopted either prospectively or retrospectively. The Company is evaluating the impact of adopting this guidance to its consolidated financial statements.

In September 2015, the FASB issued a new accounting standard that eliminates the requirement to restate prior period financial statements for measurement period adjustments following a business combination. The new guidance will be effective for the Company beginning in its first quarter of fiscal year 2017. The new guidance is not expected to have a material impact to the Company's consolidated financial statements.

In July 2015, the FASB issued an amendment to its accounting guidance related to inventory measurement. The amendment requires inventory measured using first-in, first-out (FIFO) or average cost to be subsequently measured at the lower of cost and net realizable value, thereby simplifying the current guidance that requires an entity to measure inventory at the lower of cost or market. The amendment will be effective for the Company beginning in its first quarter of fiscal year 2018. The new guidance is not expected to have a material impact to the Company's consolidated financial statements.

In April 2015, the FASB issued an amendment to its accounting guidance related to internal use software. The amendment clarifies that the software license element of a cloud computing arrangements should be accounted for consistent with the acquisition of other software licenses. The amendment will be effective for the Company beginning in its first quarter of fiscal year 2017. The Company is evaluating the impact of adopting this guidance to its consolidated financial statements.

In April 2015, the FASB issued an amendment to its accounting guidance related to retirement benefits. The amendment provides a practical expedient that permits an entity with a fiscal year-end that does not coincide with a month-end to measure defined benefit plan assets and obligations using the month-end that is closest to the entity's fiscal year-end. The amendment also provides a practical expedient that permits an entity that has a significant event in an interim period to remeasure defined benefit plan assets and obligations using the month-end that is closest to the date of the significant event. The amendment will be effective for the Company beginning in its first quarter of fiscal year 2017. The amendment is not expected to have a material impact to the Company's consolidated financial statements.

In March 2015, the FASB issued an amendment to its accounting guidance related to presentation of debt issuance costs. The amendment requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The amendment will be effective for the Company beginning in its first quarter of fiscal year 2017. In August 2015, the FASB further clarified that entities are permitted to defer and present debt issuance costs related to line-of-credit arrangements as assets. These amendments are not expected to have a material impact to the Company's consolidated financial statements.

In February 2015, the FASB issued an amendment to its accounting guidance related to consolidation. The amendment modifies the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The amendment will be effective for the Company beginning in its first quarter of fiscal year 2017. The amendment is not expected to have a material impact to the Company's consolidated financial statements.

In June 2014, the FASB issued an amendment to its accounting guidance related to stock-based compensation. The amendment requires that a performance target that could be achieved after the requisite service period be treated as a performance condition that affects vesting, rather than a condition that affects the grant-date fair value. The new guidance will be effective for the Company beginning in its first quarter of fiscal year 2017. The amendment is not expected to have a material impact to the Company's consolidated financial statements.

In May 2014, the FASB issued an amendment to its accounting guidance related to revenue recognition. The amendment sets forth a single, comprehensive revenue recognition model for all contracts with customers to improve comparability. The amendment requires revenue recognition to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In June 2015, the FASB approved a one-year deferral of the amendment. The new guidance will be effective for the Company beginning in its first quarter of fiscal year 2019, with early adoption permitted, but not before the first quarter of fiscal year 2018. The amendment can be applied either retrospectively to each prior reporting period presented (i.e., full retrospective adoption) or with the cumulative effect of initially applying the update recognized at the date of the initial application (i.e., modified retrospective adoption) along with additional disclosures. The Company is evaluating the impact of adopting this guidance to its consolidated financial statements.

## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

## 2. BALANCE SHEET COMPONENTS

The following tables summarize the Company's available-for-sale securities (in millions):

January 1, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale Securities:				
Corporate debt securities:				
CPTC loans	\$86.7	\$ —	\$ —	\$86.7
	\$86.7	\$ —	\$ —	\$86.7
October 2, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale Securities:				
Corporate debt securities:				
CPTC loans	\$83.9	\$ —	\$ —	\$83.9
Other	8.6	0.1	(0.3 )	8.4
Non-U.S. government security	0.7	—	—	0.7
	\$93.2	\$ 0.1	\$ (0.3 )	\$93.0

See Note 15, "VPT Loans" for more information on California Proton Treatment Center, LLC ("CPTC") loans.

Available-for-sale securities are included in other assets because their maturity dates are greater than one year, and the Company did not intend to sell all or a portion of its loans in the next twelve months. As of January 1, 2016, the Company anticipates that it will recover the entire amortized cost basis of all of its available-for-sale securities and determined that no other-than-temporary impairments were required to be recognized.

(In millions)	January 1, 2016	October 2, 2015
Inventories:		
Raw materials and parts	\$375.9	\$348.3
Work-in-process	88.4	98.2
Finished goods	148.8	166.1
Total inventories	\$613.1	\$612.6
(In millions)	January 1, 2016	October 2, 2015
Other long-term liabilities:		
Long-term income taxes payable	\$44.8	\$44.5
Long-term deferred income taxes	42.8	47.5
Other	62.9	62.0
Total other long-term liabilities	\$150.5	\$154.0

## 3. FAIR VALUE

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



## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

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

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

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

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

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

Type of Instruments (In millions)	Fair Value Measurement Using			Total Balance
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Assets at January 1, 2016:				
Available-for-sale securities:				
Corporate debt securities	\$—	\$—	\$86.7	\$86.7
Derivative assets	—	0.2	—	0.2
Total assets measured at fair value	\$—	\$0.2	\$86.7	\$86.9
Liabilities at January 1, 2016:				
Contingent consideration	\$—	\$—	\$(4.1)	\$(4.1)
Total liabilities measured at fair value	\$—	\$—	\$(4.1)	\$(4.1)
Assets at October 2, 2015:				
Available-for-sale securities:				
Corporate debt securities	\$—	\$8.4	\$83.9	\$92.3
Non-U.S. government security	—	0.7	—	0.7
Total assets measured at fair value	\$—	\$9.1	\$83.9	\$93.0
Liabilities at October 2, 2015:				
Contingent consideration	\$—	\$—	\$(4.1)	\$(4.1)
Total liabilities measured at fair value	\$—	\$—	\$(4.1)	\$(4.1)

The Company's available-for-sale securities are included in other assets, derivative assets are included in prepaid expenses and other current assets, and contingent consideration is included in accrued liabilities and other long-term liabilities on the Condensed Consolidated Balance Sheets.

The fair value of the Company's Level 2 other corporate debt securities and non-U.S. government security are priced using quoted market prices for similar instruments or non-binding market prices that are corroborated by observable market data. The Company has elected to use the income approach to value its derivative instruments using standard valuation techniques and Level 2 inputs, such as currency spot rates, forward points and credit default swap spreads.

The Company's derivative instruments are generally short-term in nature, typically one month to thirteen months in duration.

The fair value of the Company's Level 3 corporate debt securities, the CPTC loans, is based on the income approach by using the discounted cash flow model with key assumptions that include discount rates corresponding to the terms and risks associated with the loans to CPTC. If the estimated discount rates used were to increase or decrease, the fair value of the debt securities would decrease or increase, respectively. However, the Company does not increase the fair value of these securities

## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

above their par values as ORIX Capital Markets, LLC (“ORIX”), the loan agent, has the option to purchase these loans from the Company under the original terms and conditions at par value.

The Company measures the fair value of its Level 3 contingent consideration liabilities based on the income approach by using a discounted cash flow model with key assumptions that include estimated sales units or revenues of the acquired business or completion of certain milestone targets during the earn-out period, volatility, and estimated discount rates corresponding to the periods of expected payments. If the estimated sales units, revenues or probability of completing certain milestones were to increase or decrease during the respective earn-out period, the fair value of the contingent consideration would increase or decrease, respectively. If the estimated discount rates were to increase or decrease, the fair value of contingent consideration would decrease or increase, respectively. Changes in volatility may result in an increase or decrease in the fair value of contingent consideration.

The following table presents the reconciliation for all assets and liabilities measured and recorded at fair value on a recurring basis using significant unobservable inputs (Level 3):

(In millions)	CPTC Loans	Contingent Consideration
Balance at October 2, 2015	\$83.9	\$(4.1 )
Additions <sup>(1)</sup>	2.8	—
Balance at January 1, 2016	\$86.7	\$(4.1 )

(1) Amounts reported under CPTC loans include accrued interest.

There were no transfers of assets or liabilities between fair value measurement levels during either the three months ended January 1, 2016, or the three months ended January 2, 2015. Transfers between fair value measurement levels are recognized at the end of the reporting period.

#### Fair Value of Other Financial Instruments

The fair values of certain of the Company’s financial instruments, including bank deposits included in cash and cash equivalents, accounts receivable, net of allowance for doubtful accounts, short-term notes receivable, accounts payable, and short-term borrowings approximate their carrying amounts due to their short maturities.

As of both January 1, 2016 and October 2, 2015, the fair value of current maturities of long-term debt approximated its carrying value of \$50.0 million, due to its short-term maturity. The fair value of the long-term debt payable in installments through fiscal year 2018 approximated its carrying value of \$325.0 million and \$337.5 million, at January 1, 2016 and October 2, 2015, respectively, because it is carried at a market observable interest rate that resets periodically and is categorized as Level 2 in the fair value hierarchy.

The fair value of the outstanding long-term notes receivable approximated their carrying value of \$33.0 million and \$30.9 million at January 1, 2016 and October 2, 2015, respectively, because it is based on terms of recent comparable transactions and is categorized as Level 3 in the fair value hierarchy.

## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

## 4. RECEIVABLES

The following table summarizes the Company's accounts receivable and notes receivable as of January 1, 2016 and October 2, 2015:

(In millions)	January 1, 2016	October 2, 2015
Accounts receivable, gross	\$857.8	\$838.2
Allowance for doubtful accounts	(25.0)	)(21.2)
Accounts receivable, net	\$832.8	\$817.0
Short-term	\$768.5	\$770.9
Long-term	\$64.3	\$46.1
Notes receivable	\$43.0	\$40.9
Short-term	\$10.0	\$10.0
Long-term	\$33.0	\$30.9

A financing receivable represents a financing arrangement with a contractual right to receive money, on demand or on fixed or determinable dates, and that is recognized as an asset on the Company's Condensed Consolidated Balance Sheets. The Company's financing receivables consist of accounts receivable with contractual maturities of more than one year and notes receivable. A small portion of the Company's financing accounts receivables were within the short-term accounts receivable.

Allowance for doubtful accounts is entirely related to the short-term accounts receivable as of January 1, 2016 and October 2, 2015. There was no material activity in the allowance for doubtful financing accounts receivable during both the three months ended January 1, 2016 and January 2, 2015, respectively.

See Note 15, "VPT Loans" for more information on the Company's long-term notes receivable balances.

## 5. GOODWILL AND INTANGIBLE ASSETS

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

(In millions)	Oncology Systems	Imaging Components	Other	Total
Balance at October 2, 2015	\$158.8	\$74.7	\$50.0	\$283.5
Foreign currency translation adjustments	—	—	(1.7)	)(1.7)
Balance at January 1, 2016	\$158.8	\$74.7	\$48.3	\$281.8

The following table reflects the gross carrying amount and accumulated amortization of the Company's finite-lived intangible assets included in other assets in the Condensed Consolidated Balance Sheets:

(In millions)	January 1, 2016	October 2, 2015
Finite-lived intangible assets:		
Acquired existing technology	\$71.7	\$71.7
Patents, licenses and other	34.7	35.3
Customer contracts and supplier relationship	20.1	20.1
Accumulated amortization	(68.0)	)(65.1)
Net carrying amount	\$58.5	\$62.0

As of January 1, 2016 and October 2, 2015, the Company also had \$10.6 million of in-process research and development assets.

Amortization expense for intangible assets was \$3.0 million and \$1.6 million in the three months ended January 1, 2016 and January 2, 2015, respectively. The Company estimates the amortization expense for the remaining nine

months of fiscal year

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

2016, fiscal years 2017 through 2020, and thereafter, will be as follows (in millions): \$10.0, \$13.1, \$9.6, \$9.0, \$7.7, and \$9.1, respectively.

6. RELATED PARTY TRANSACTIONS

VMS has a 40% ownership interest in dpiX Holding LLC (“dpiX Holding”), a two-member consortium which has a 100% ownership interest in dpiX LLC (“dpiX”), a supplier of amorphous silicon based thin film transistor arrays (“flat panels”) for the Company’s Imaging Components’ digital image detectors, for its Oncology Systems’ On-Board Imager® and PortalVision™ imaging products as well as the imaging system in its Varian Particle Therapy ProBeam® system. In accordance with the dpiX Holding agreement, net profits or losses are allocated to the members, in accordance with their ownership interests.

The equity investment in dpiX Holding is accounted for under the equity method of accounting. When VMS recognizes its share of net profits or losses of dpiX Holding, profits or losses in inventory purchased from dpiX are eliminated until realized by VMS. VMS recorded losses of \$0.7 million and \$0.4 million in the three months ended January 1, 2016 and January 2, 2015, respectively, from its equity investment in dpiX Holding. Income and loss on the equity investment in dpiX Holding is included in selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings. The carrying value of the equity investment in dpiX Holding, which is included in other assets on the Condensed Consolidated Balance Sheets, was \$47.3 million at both January 1, 2016 and at October 2, 2015.

The Company purchased glass transistor arrays from dpiX totaling \$5.0 million and \$4.3 million in the three months ended January 1, 2016 and January 2, 2015, respectively. These purchases of glass transistor arrays are included as a component of inventories on the Condensed Consolidated Balance Sheets or cost of revenues - product in the Condensed Consolidated Statements of Earnings for these fiscal periods.

In October 2013, VMS entered into an amended agreement with dpiX and other parties that, among other things, provides the Company with the right to 50% of dpiX’s total manufacturing capacity produced after January 1, 2014. The amended agreement requires the Company to pay for 50% of the fixed costs (as defined in the amended agreement), as determined at the beginning of each calendar year. As of January 1, 2016, the Company had fixed cost commitments of \$18.0 million related to this amended agreement through December 31, 2016. The fixed cost commitments for future periods will be determined and approved by the dpiX board of directors at the beginning of each calendar year. The amended agreement will continue unless the ownership structure of dpiX changes (as defined in the amended agreement).

The Company has determined that dpiX is a variable interest entity because at-risk equity holders, as a group, lack the characteristics of a controlling financial interest. Majority votes are required to direct the manufacturing activities, legal operations and other activities that most significantly affect dpiX’s economic performance. The Company does not have majority voting rights and no power to direct the activities of dpiX and therefore is not the primary beneficiary of dpiX. The Company’s exposure to loss as a result of its involvement with dpiX is limited to the carrying value of the Company’s investment and fixed cost commitments.

## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

## 7. BORROWINGS

The following table summarizes the Company's short-term and long-term debt:

(In millions)	January 1, 2016			October 2, 2015		
	Amount	Weighted-Average Interest Rate		Amount	Weighted-Average Interest Rate	
Short-term debt:						
Current maturities of 2013 Term Loan Facility	\$50.0	1.42	%	\$50.0	1.32	%
2013 Revolving Credit Facility	315.0	1.56	%	90.0	1.57	%
Sumitomo Credit Facility	18.2	0.63	%	18.4	0.63	%
Total short-term debt	\$383.2			\$158.4		
Long-term debt:						
2013 Term Loan Facility	\$325.0	1.42	%	\$337.5	1.32	%
2013 Revolving Credit Facility	20.0	3.75	%	—	—	%
Total long-term debt	\$345.0			\$337.5		

On August 27, 2013, VMS entered into an agreement (as amended to date) with certain lenders and Bank of America, N.A. ("BoFA") as administrative agent ("Credit Agreement"). The Credit Agreement provides for (i) a five-year term loan facility in an aggregate principal amount of up to \$500 million (the "2013 Term Loan Facility") and (ii) a five-year revolving credit facility in an aggregate principal amount of up to \$500 million (the "2013 Revolving Credit Facility" and, collectively with the 2013 Term Loan Facility, the "2013 Credit Facility"). The 2013 Revolving Credit Facility also includes a \$50 million sub-facility for the issuance of letters of credit and permits swing line loans of up to \$25 million. In November 2015, the Company amended its Credit Agreement to increase the aggregate commitments under its revolving credit facility from \$300 million to \$500 million, reduce commitment fees and interest rate margins applicable to borrowings and increase the maximum consolidated leverage ratio that the Company must maintain. The 2013 Credit Facility contains provisions that limit the Company's ability to pay cash dividends. The Credit Agreement will expire in August 2018. The proceeds of the 2013 Credit Facility may be used for working capital, capital expenditures, Company share repurchases, acquisitions and other corporate purposes.

Borrowings under the 2013 Term Loan Facility accrue interest either (i) based on a Eurodollar Rate, as defined in the Credit Agreement (the "Eurodollar Rate"), plus a margin of 0.875% to 1.125% based on a leverage ratio involving funded indebtedness and EBITDA or (ii) based upon a base rate of (a) the federal funds rate plus 0.50%, (b) BoFA's announced prime rate, or (c) the Eurodollar Rate plus 1.00%, whichever is highest, plus a margin of up to 0.125% based on the same leverage Ratio, depending upon instructions from the Company.

Borrowings under the 2013 Revolving Credit Facility accrue interest either (i) based on the Eurodollar Rate plus a margin of 1.125% to 1.375% based on a leverage ratio involving funded indebtedness and EBITDA or (ii) based upon a base rate of (a) the federal funds rate plus 0.50%, (b) BoFA's announced prime rate, or (c) the Eurodollar Rate plus 1.00%, whichever is highest, plus a margin of 0.125% to 0.375% based on the same leverage ratio, depending upon instructions from the Company. Borrowings under the 2013 Revolving Credit Facility have a maturity of approximately 30 days if based on the Eurodollar Rate and the same maturity as the 2013 Term Loan Facility if based on the base rate.

Subject to certain limitations on the amount secured, the Company has pledged 65% of the voting shares issued by Varian Medical Systems Nederland Holdings B.V., a wholly owned subsidiary, as security for the 2013 Credit Facility. This share pledge also secures all hedging or treasury management obligations entered into by the Company with a Lender. The Credit Agreement provides that certain material domestic subsidiaries must guarantee the 2013 Credit Facility, subject to certain limitations on the amount secured. As of January 1, 2016, the 2013 Credit Facility was not guaranteed by any VMS subsidiary.

The Credit Agreement contains affirmative and negative covenants applicable to the Company and its subsidiaries that are typical for credit facilities of this type, and that are subject to materiality and other qualifications, carve-outs, baskets and exceptions. The Company has also agreed to maintain certain financial covenants including (i) a maximum consolidated leverage ratio, involving funded indebtedness and EBITDA (earnings before interest, tax and depreciation and amortization),



## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

and (ii) a minimum cash flow coverage ratio. The Company was in compliance with all covenants under the Credit Agreement for all periods within these condensed consolidated financial statements in which it was in existence.

VMS's Japanese subsidiary ("VMS KK") has an unsecured uncommitted credit agreement with Sumitomo that enables VMS KK to borrow and have outstanding at any given time a maximum of 3 billion Japanese Yen (the "Sumitomo Credit Facility"). In February 2016, the Sumitomo Credit Facility was extended and will expire in February 2017. Borrowings under the Sumitomo Credit Facility accrue interest based on the basic loan rate announced by the Bank of Japan plus a margin of 0.5% per annum.

## 8. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company measures all derivatives at fair value on the Condensed Consolidated Balance Sheets. The accounting for gains or losses resulting from changes in the fair value of those derivatives depends upon the use of the derivative and whether it qualifies for hedge accounting.

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

		Asset Derivatives	
		January 1, 2016	October 2, 2015
(In millions)	Balance Sheet Location	Fair Value	Fair Value
Derivatives designated as hedging instruments:			
Foreign exchange forward contracts	Prepaid expenses and other current assets	\$0.2	\$—
Total derivatives		\$0.2	\$—

At January 1, 2016 and October 2, 2015, the fair value of the Company's derivatives not designated as hedging instruments was immaterial. See Note 3, "Fair Value" regarding valuation of the Company's derivative instruments. Also see Note 1, "Summary of Significant Accounting Policies" in the Consolidated Financial Statements in the Company's 2015 Annual Report regarding credit risk associated with the Company's derivative instruments.

## Offsetting of Derivatives

The Company presents its derivative assets and derivative liabilities on a gross basis on the Condensed Consolidated Balance Sheets. However, under agreements containing provisions on netting with certain counterparties of foreign exchange contracts, subject to applicable requirements, the Company is allowed to net-settle transactions on the same date in the same currency, with a single net amount payable by one party to the other. As of January 1, 2016 and October 2, 2015, there were no potential effects of rights of setoff associated with derivative instruments. The Company is neither required to pledge nor entitled to receive cash collateral related to these derivative transactions.

## Cash Flow Hedging Activities

The Company designates and accounts for certain of its hedges of forecasted foreign currency revenues as cash flow hedges. The Company's designated cash flow hedges de-designate when the anticipated revenues associated with the transactions are recognized and the effective portion in accumulated other comprehensive loss on the Condensed Consolidated Balance Sheets is reclassified to revenues in the Condensed Consolidated Statements of Earnings. Subsequent changes in fair value of the derivative instrument are recorded in selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings to offset changes in fair value of the resulting non-functional currency receivables. For derivative instruments that are designated and qualify as cash flow hedges, the Company formally documents for each derivative instrument at the hedge's inception the relationship between the

hedging instrument (foreign currency forward contract) and hedged item (forecasted foreign currency revenues), the nature of the risk being hedged, and its risk management objective and strategy for undertaking the hedge. The Company records the effective portion of the gain or loss on the derivative instruments that are designated and qualify as cash flow hedges in accumulated other comprehensive loss on the Condensed Consolidated Balance Sheets and reclassifies these amounts into revenues in the Condensed Consolidated Statements of Earnings in the period during which the hedged transaction is recognized in earnings. The Company assesses hedge effectiveness both at the onset of the hedge and on an ongoing basis using regression analysis. The Company measures hedge ineffectiveness by comparing the cumulative change

## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

in the fair value of the effective component of the hedge contract with the cumulative change in the fair value of the hedged item. The Company recognizes any over performance of the derivative as ineffectiveness in revenues, and time value amounts excluded from the assessment of effectiveness in cost of revenues in the Condensed Consolidated Statements of Earnings. During the three months ended January 1, 2016, the Company did not discontinue any cash flow hedges. At the inception of the hedge relationship and quarterly after, the Company assesses whether the likelihood of meeting the forecasted cash flow is highly probable. As of January 1, 2016, all forecasted cash flows were still probable to occur. As of January 1, 2016, the net unrealized gain on derivative instruments, before tax, of \$0.1 million was included in accumulated other comprehensive loss and is expected to be reclassified to earnings over the next 12 months that follows.

The Company had the following outstanding foreign currency forward contracts that were entered into to hedge forecasted revenues and designated as cash flow hedges:

	January 1, 2016 Notional Value Sold
(In millions)	
Euro	\$49.5
Totals	\$49.5

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

	Gain Recognized in Other Comprehensive Income (Effective Portion)		Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Net Earnings (Effective Portion)	Gain Reclassified from Accumulated Other Comprehensive Income into Net Earnings (Effective Portion)	
	Three Months Ended January 1, 2016	January 2, 2015		Three Months Ended January 1, 2016	January 2, 2015
(In millions)					
Foreign currency forward contracts	\$0.1	\$0.8	Revenues	\$—	\$0.9

## Balance Sheet Hedging Activities

The Company also hedges balance sheet exposures from its various subsidiaries and business units where the U.S. Dollar is the functional currency. The Company enters into foreign currency forward contracts to minimize the short-term impact of foreign currency fluctuations on monetary assets and liabilities denominated in currencies other than the U.S. Dollar functional currency. The foreign currency forward contracts are short term in nature, typically with a maturity of approximately one month, and are based on the net forecasted balance sheet exposure. These hedging instruments do not qualify for hedge accounting treatment. 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 rate movement, may result in a material gain or loss if the hedges are not effectively offsetting the change in value of the foreign currency asset or liability. Other than foreign exchange hedging activities, the Company has no other free-standing or embedded derivative instruments.

## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

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

(In millions)	January 1, 2016	
	Notional Value Sold	Notional Value Purchased
Australian Dollar	\$18.7	\$—
Brazilian Real	2.6	—
British Pound	47.1	—
Canadian Dollar	—	5.2
Danish Krone	—	0.4
Euro	237.5	1.0
Hungarian Forint	16.2	—
Indian Rupee	12.0	—
Japanese Yen	64.2	—
Swedish Krona	7.6	—
Swiss Franc	—	72.4
Thai Baht	3.1	—
Totals	\$409.0	\$79.0

The following table presents the gains recognized in the Condensed Consolidated Statements of Earnings related to the foreign currency forward exchange contracts that are not designated as hedging instruments:

Location of Gain Recognized in Income on Derivative	Amount of Gain Recognized in Net Earnings on Derivative Three Months Ended	
	January 1, 2016	January 2, 2015
(In millions)		
Selling, general and administrative expenses	\$7.4	\$11.5

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

## Contingent Features

Certain of the Company's derivative instruments are subject to master agreements which contain provisions that require the Company, in the event of a default, to settle the outstanding contracts in net liability positions by making settlement payments in cash or by setting off amounts owed to the counterparty against any credit support or collateral held by the counterparty. As of January 1, 2016 and October 2, 2015, the Company did not have significant outstanding derivative instruments with credit-risk-related contingent features that were in a net liability position.

## 9. COMMITMENTS AND CONTINGENCIES

## Product Warranty

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

(In millions)	Three Months Ended	
	January 1, 2016	January 2, 2015

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Accrued product warranty, at beginning of period	\$45.9	\$49.3	
Charged to cost of revenues	12.2	9.4	
Actual product warranty expenditures	(12.0	) (13.0	)
Accrued product warranty, at end of period	\$46.1	\$45.7	

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

Long-term accrued product warranty costs of \$1.9 million and \$2.0 million are included under other long-term liabilities on the Condensed Consolidated Balance Sheets as of January 1, 2016 and October 2, 2015, respectively. The remaining short-term accrued product warranty is included under accrued liabilities on the Condensed Consolidated Balance Sheets.

Other Commitments

See Note 15, "VPT Loans" for additional information about the Company's commitments for funding development and construction of various proton therapy centers .

Contingencies

Environmental Remediation Liabilities

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

The Company spent \$0.2 million and \$0.3 million (net of amounts borne by VI and VSEA) in the three months ended January 1, 2016 and January 2, 2015, respectively, on environmental cleanup costs, third-party claim costs, project management costs and legal costs.

Inherent uncertainties make it difficult to estimate the likelihood of the cost of future cleanup, third-party claims, project management and legal services for the CERCLA sites and one of the Company's past facilities. Nonetheless, as of January 1, 2016, the Company estimated that, net of VI's and VSEA's indemnification obligations, future costs associated with the CERCLA sites and this facility would range in total from \$1.4 million to \$9.8 million. The time frames over which these cleanup project costs are estimated vary, ranging from one year to thirty years as of January 1, 2016. Management believes that no amount in that range is more probable of being incurred than any other amount and therefore accrued \$1.4 million for these cleanup projects as of January 1, 2016. The accrued amount has not been discounted to present value due to the uncertainties that make it difficult to develop a single best estimate. The Company believes it has gained sufficient knowledge to better estimate the scope and cost of monitoring, cleanup and management activities for its other past and present facilities. This, in part, is based on agreements with other parties and also cleanup plans approved by or completed in accordance with the requirements of the governmental agencies having jurisdiction. As of January 1, 2016, the Company estimated that the Company's future exposure, net of VI's and VSEA's indemnification obligations, for the costs at these facilities, and reimbursements of third-party's claims for these facilities, ranged in total from \$5.3 million to \$25.7 million. The time frames over which these costs are estimated to be incurred vary, ranging from one year to thirty years as of January 1, 2016. As to each of these

facilities, management determined that a particular amount within the range of estimated costs was a better estimate than any other amount within the range, and that the amount and timing of these future costs were reliably determinable. The best estimate within that range was \$8.7 million at January 1, 2016. Accordingly, the Company has accrued \$7.2 million for these costs, which represents the best estimate discounted at 4%, net of inflation. This accrual is in addition to the \$1.4 million described in the preceding paragraph.

These amounts are only estimates of anticipated future costs. The amounts the Company will actually spend may be greater or less than these estimates, even as the Company believes the degree of uncertainty will narrow as cleanup activities progress.

VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

While the Company believes its reserve is adequate, as the scope of the Company's obligations becomes more clearly defined, the Company may modify the reserve, and charge or credit future earnings accordingly. Nevertheless, based on information currently known to management, and assuming VI and VSEA satisfy their indemnification obligations, management believes the costs of these environmental-related matters are not reasonably likely to have a material adverse effect on the consolidated financial statements of the Company in any one fiscal year.

The Company evaluates its liability for investigation and cleanup costs in light of the obligations and apparent financial strength of potentially responsible parties and insurance companies with respect to which the Company believes it has rights to indemnity or reimbursement. The Company has asserted claims for recovery of environmental investigation and cleanup costs already incurred, and to be incurred in the future against various insurance companies and other third parties. The Company receives certain cash payments in the form of settlements and judgments from defendants, insurers and other third parties from time to time. The Company has also reached an agreement with an insurance company under which that insurer has agreed to pay a portion of the Company's past and future environmental-related expenditures. Receivables, net of VI's and VSEA's portion, from that insurer amounted to \$1.9 million at January 1, 2016 and \$2.1 million at October 2, 2015, with the noncurrent receivables portion included in other assets and the payable portion to that insurer is included in other long-term liabilities on the Condensed Consolidated Balance Sheets. The Company believes that this receivable is recoverable because it is based on a binding, written settlement agreement with what appears to be a financially viable insurance company, and the insurance company has paid the Company's claims in the past.

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

Other Matters

From time to time, the Company is a party to or otherwise involved in legal proceedings, claims and government inspections or investigations and other legal matters, both inside and outside the United States, arising in the ordinary course of its business or otherwise. The Company accrues amounts, to the extent they can be reasonably estimated, that it believes are adequate to address any liabilities related to legal proceedings and other loss contingencies that the Company believes will result in a probable loss (including, among other things, probable settlement value). A loss or a range of loss is disclosed when it is reasonably possible that a material loss will be incurred and can be estimated or when it is reasonably possible that the amount of a loss, when material, will exceed the recorded provision.

In September 2015, Elekta Ltd. and William Beaumont Hospital served the Company with a complaint alleging infringement of three patents related to certain aspects of cone beam imaging in conjunction with radiotherapy. During September 2015 and October 2015, the Company filed several complaints in the U.S. and foreign courts and the U.S. International Trade Commission against Elekta AB and its subsidiaries alleging infringement of various patents relating to certain aspects of cone beam imaging, cone-beam imaging gantries, volumetric modulated arc therapy ("VMAT"), and MR-Linac. These lawsuits are in the initial stages and at this time, and the Company is unable to predict the ultimate outcome of this matter. Therefore, no amounts have been accrued as of January 1, 2016.

In June 2015, a foreign subsidiary of the Company was charged by the Department for Investigation and Penal Action of Lisbon with alleged improper activities relating to three tenders of medical equipment in Portugal during the period of 2003 to 2009. The Company has requested a judicial review available under Portuguese criminal procedure processes as to whether or not such changes are proper under Portuguese law. The Company previously undertook an internal investigation of this matter and voluntarily disclosed the results of this investigation to the U.S. Department of Justice and the U.S. Securities and Exchange Commission. At this time, the Company is unable to predict the ultimate



outcome of this matter, and therefore no amounts have been accrued as of January 1, 2016.

In addition to the above, the Company is involved in other legal matters. However, such matters are subject to many uncertainties and outcomes are not predictable with assurance. The Company is unable to estimate a range of reasonably possible losses with respect to such matters. There can be no assurances as to whether the Company will become subject to significant additional claims and liabilities with respect to ongoing or future proceedings. If actual liabilities significantly exceed the estimates made, the Company's consolidated financial position, results of operations or cash flows could be materially adversely affected. Legal expenses relating to legal matters are expensed as incurred.

## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

## Restructuring Charges

As part of the Company's plan to enhance operational performance through productivity initiatives, the Company incurred a workforce reduction, primarily in its Oncology Systems and Imaging Components segments, in the first quarter of fiscal year 2016. The Company incurred \$4.8 million in restructuring charges in connection with the above mentioned restructuring program, of which \$2.7 million was paid in cash during the three months ended January 1, 2016. The Company expects to complete the above mentioned restructuring program by the end of fiscal year 2016, and any remaining restructuring charges are not expected to be material.

The Company incurred \$10.5 million in restructuring charges related to an enhanced retirement program and workforce reduction in fiscal year 2015 during the three months ended January 2, 2015.

## 10. RETIREMENT PLANS

The Company sponsors seven defined benefit pension plans for regular full time employees in Germany, Japan, Switzerland, the Philippines and the United Kingdom. The Company also sponsors a post-retirement benefit plan that provides healthcare benefits to certain eligible retirees in the United States. Two of the Company's defined benefit pension plans including one in Germany and one in the Philippines and the Company's post-retirement benefit plan are not presented in any of the following information as they are not material.

The components of net defined benefit costs were as follows:

(In thousands)	Three Months Ended	
	January 1, 2016	January 2, 2015
Defined Benefit Plans		
Service cost	\$1,475	\$1,187
Interest cost	1,040	1,295
Expected return on plan assets	(1,739)	(1,816)
Amortization of prior service cost	9	47
Recognized actuarial loss	726	614
Net periodic benefit cost	\$1,511	\$1,327

The Company currently expects total contributions to the defined benefit plans for fiscal year 2016 will be approximately \$7.4 million.

## 11. INCOME TAXES

The Company's effective tax rate was 24.8% for the three months ended January 1, 2016, compared to 28.5% for the year-ago period of fiscal year 2015. The decrease in the Company's effective tax rate during the three months ended January 1, 2016 compared to the year ago period, was primarily due to the geographic mix of earnings and the reinstatement of the federal research and development tax credit.

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

The total amount of unrecognized tax benefits did not materially change during the three months ended January 1, 2016; however, the amount of unrecognized tax benefits has increased as a result of positions taken during the current and prior years, and has decreased as the result of the expiration of the statutes of limitation in various jurisdictions.

## 12. STOCKHOLDERS' EQUITY AND NONCONTROLLING INTERESTS

## Share Repurchase Program

In November 2015, the VMS Board of Directors authorized the repurchase of an additional 8,000,000 shares of VMS common stock through December 31, 2016. Share repurchases under the Company's authorizations may be made in open market purchases, in privately negotiated transactions (including accelerated share repurchase programs), or under Rule 10b5-1 share

## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

repurchase plans, and may be made from time to time in one or more blocks. All shares that were repurchased under the Company's share repurchase programs have been retired.

The Company repurchased shares of VMS common stock under various authorizations during the periods presented as follows:

	Three Months Ended	
	January 1, 2016	January 2, 2015
(in thousands, except per share amounts)		
Number of shares	2,425	1,500
Average repurchase price per share	\$79.20	\$83.69
Total cost	\$192,077	\$125,535

As of January 1, 2016, 7,000,000 shares of VMS common stock remained available for repurchase under the November 2015 authorization. Subsequent to January 1, 2016, the Company paid \$40.4 million and received 519,186 shares of VMS common stock as part of an accelerated share repurchase.

## Other Comprehensive Earnings

The changes in accumulated other comprehensive earnings (loss) by component and related tax effects are summarized as follows:

(in thousands)	Net Unrealized Gains (Losses) Defined Benefit Pension and Post-Retirement Benefit Plans	Net Unrealized Gains (Losses) Cash Flow Hedging Instruments	Net Unrealized Gains (Losses) Available for Sale Securities	Cumulative Translation Adjustment	Accumulated Other Comprehensive Earnings (Loss)
Balance at October 2, 2015	\$ (46,070 )	\$ —	\$ (112 )	\$ (40,281 )	\$ (86,463 )
Other comprehensive earnings before reclassifications	—	145	(440 )	(4,653 )	(4,948 )
Amounts reclassified out of other comprehensive earnings	616	—	604	—	1,220
Tax expense	(87 )	(54 )	(52 )	—	(193 )
Balance at January 1, 2016	\$ (45,541 )	\$ 91	\$ —	\$ (44,934 )	\$ (90,384 )

(in thousands)	Net Unrealized Gain (Loss) Defined Benefit Pension and Post-Retirement Benefit Plans	Net Unrealized Gain (Loss) Cash Flow Hedging Instruments	Cumulative Translation Adjustment	Accumulated Other Comprehensive Earnings (Loss)
Balance at September 26, 2014	\$ (44,060 )	\$ 965	\$ (15,516 )	\$ (58,611 )
Other comprehensive earnings before reclassifications	—	759	(12,290 )	(11,531 )
Amounts reclassified out of other comprehensive earnings	541	(871 )	—	(330 )
Tax expense (benefit)	(75 )	42	—	(33 )
Balance at January 2, 2015	\$ (43,594 )	\$ 895	\$ (27,806 )	\$ (70,505 )



## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

The amounts reclassified out of other comprehensive earnings into the Condensed Consolidated Statements of Earnings, with line item location, during each period were as follows:

(in thousands)	Three Months Ended		Line Item in Statements of Earnings
	January 1, 2016	January 2, 2015	
Comprehensive Earnings Components	Income (Loss) Before Taxes		
Unrealized loss on defined benefit pension and post-retirement benefit plans	\$(616)	) \$(541)	Cost of revenues & Operating expenses
Unrealized gain on cash flow hedging instruments	—	871	Revenues
Unrealized loss on available-for-sale-investments	(604)	) —	Operating expenses
Total amounts reclassified out of other comprehensive earnings	\$(1,220)	) \$330	

## Noncontrolling Interests

In April 2015, the Company completed the acquisition of 73.5% of the then outstanding shares of MeVis Medical Solutions AG ("MeVis"), a public company based in Bremen, Germany that provides image processing software and services for cancer screening.

In August 2015, the Company, through one of its German subsidiaries, entered into a domination and profit and loss transfer agreement (the "DPLTA") with MeVis. During the three months ended January 1, 2016, the DPLTA became effective upon its registration at the local court of Bremen, Germany. Under the DPLTA, MeVis subordinates its management to the Company and undertakes to transfer all of its annual profits and losses to the Company. In return, the DPLTA grants the noncontrolling shareholders of MeVis: (1) an annual recurring net compensation of €0.95 per MeVis share starting from January 1, 2015 and (2) a put right for their MeVis shares at €19.77 per MeVis share. Upon effectiveness of the DPLTA, the noncontrolling interests in MeVis became redeemable as a result of the put right and were reclassified to temporary equity. As of January 1, 2016, the redemption value of redeemable noncontrolling interests in MeVis was \$10.4 million.

During the three months ended January 1, 2016, an immaterial number of MeVis' shares were purchased under the put right. As of January 1, 2016, noncontrolling shareholders together held approximately 482,000 shares of MeVis, representing about 26.5% of the outstanding shares.

Changes in noncontrolling interests and redeemable noncontrolling interests relating to MeVis and other subsidiaries of the Company were as follows:

(in thousands)	Noncontrolling Interests	Redeemable Noncontrolling Interests
Balance at October 2, 2015	\$ 14,744	\$ —
Net income attributable to noncontrolling interests	15	—
Reclassification of noncontrolling interests in MeVis to redeemable noncontrolling interests	(10,382)	) 10,382
Other	(499)	) —
Balance at January 1, 2016	\$ 3,878	\$ 10,382

## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

## 13. EMPLOYEE STOCK PLANS

The table below summarizes the net share-based compensation expense recognized for employee stock awards and for the option component of the employee stock purchase plan shares:

(In thousands)	Three Months Ended	
	January 1, 2016	January 2, 2015
Cost of revenues - Product	\$991	\$1,109
Cost of revenues - Service	989	952
Research and development	1,577	1,738
Selling, general and administrative	7,698	8,938
Total share-based compensation expense	\$11,255	\$12,737
Income tax benefit for share-based compensation	\$(3,458)	\$(3,973)

During the three months ended January 1, 2016 and January 2, 2015, the Company granted performance units to certain employees under the Third Amended 2005 Plan. The number of shares of VMS common stock ultimately issued under the performance units at vesting depend on the Company's business performance during the performance period, against specified performance targets, both of which are set by the Compensation and Management Development Committee of the Board of Directors. The performance units vest at the end of a three-year service period. Performance units granted prior to fiscal year 2015 have one three-year performance period for both the Company's performance and total shareholder return, performance units granted in fiscal year 2015 have a one year Company performance period and a three year total shareholder return, and performance units awarded in fiscal year 2016 have three separate one-year Company performance periods and a three year total shareholder return. Subject to certain exceptions, any unvested performance unit awards are forfeited at the time of termination.

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

Employee Stock Option Plans	Three Months Ended			
	January 1, 2016	January 2, 2015		
Expected term (in years)	4.13	4.52		
Risk-free interest rate	1.4	% 1.5	%	
Expected volatility	20.5	% 22.8	%	
Expected dividend	—	% —	%	
Weighted average fair value at grant date	\$15.44	\$19.20		

The option component of employee stock purchase plan shares was estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions:

Employee Stock Purchase Plan	Three Months Ended			
	January 1, 2016	January 2, 2015		
Expected term (in years)	0.50	0.50		
Risk-free interest rate	0.3	% 0.1	%	
Expected volatility	17.0	% 8.3	%	
Expected dividend	—	% —	%	
Weighted average fair value at grant date	\$15.59	\$14.24		





## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

A summary of share-based awards available for grant is as follows:

(In thousands)	Shares Available for Grant
Balance at October 2, 2015	6,661
Granted	(378 )
Cancelled or expired	217
Balance at January 1, 2016	6,500

Awards other than stock options set forth in the table were calculated under the Third Amended 2005 Plan as 2.6 shares for every one share awarded. The shares available for grant is further adjusted to reflect a maximum payout that could be issued for each performance unit granted. The maximum payouts that could be issued for each performance unit granted are 1.75 shares beginning in fiscal year 2016, 2.0 shares in fiscal year 2015 and 1.5 shares prior to fiscal year 2015.

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

(In thousands, except per share amounts)	Options Outstanding		Weighted Average Remaining Term (in years)	Aggregate Intrinsic Value (1)
	Number of Shares	Weighted Average Exercise Price		
Balance at October 2, 2015	2,537	\$72.58		
Granted	12	80.78		
Cancelled or expired	(9 )	86.22		
Exercised	(133 )	52.97		
Balance at January 1, 2016	2,407	\$73.65	4.0	\$26,024
Exercisable at January 1, 2016	1,551	\$64.75	3.0	\$25,985

The aggregate intrinsic value represents the total pre-tax intrinsic value of options, which is computed based on the difference between the exercise price and VMS's closing common stock price of \$80.80 as of December 31, 2015, the last trading date of the first quarter of fiscal year 2016, and which would have been received by the option holders had all option holders exercised and sold their options as of that date.

As of January 1, 2016, there was \$8.2 million of total unrecognized compensation expense related to outstanding stock options. This unrecognized compensation expense is expected to be recognized over a weighted average period of 1.6 years.

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

(In thousands, except per share amounts)	Number of Shares	Weighted Average Grant-Date Fair Value
Balance at October 2, 2015	950	\$84.11
Granted	85	83.42
Vested	(153 )	71.13

Cancelled or expired	(57	) 81.08
Balance at January 1, 2016	825	\$86.85

As of January 1, 2016, unrecognized compensation expense totaling \$26.9 million was related to awards of restricted stock, restricted stock units, deferred stock units and performance units. This unrecognized compensation expense is expected to be recognized over a weighted average period of 1.7 years.

## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

## 14. EARNINGS PER SHARE

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

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

	Three Months Ended	
	January 1, 2016	January 2, 2015
(In thousands, except per share amounts)		
Net earnings attributable to Varian	\$89,027	\$93,314
Weighted average shares outstanding - basic	97,156	100,468
Dilutive effect of potential common shares	687	1,174
Weighted average shares outstanding - diluted	97,843	101,642
Net earnings per share attributable to Varian - basic	\$0.92	\$0.93
Net earnings per share attributable to Varian - diluted	\$0.91	\$0.92
Anti-dilutive employee shared based awards, excluded	1,244	504

The Company excludes potentially dilutive common shares (consisting of shares underlying stock options and the employee stock purchase plan) from the computation of diluted weighted average shares outstanding if the per share value, either the exercise price of the awards or the sum of (a) the exercise price of the awards and (b) the amount of the compensation cost attributed to future services and not yet recognized and (c) the amount of tax benefit or shortfall that would be recorded in additional paid-in capital when the award becomes deductible, is greater than the average market price of the shares, because the inclusion of the shares underlying these stock awards would be anti-dilutive to earnings per share.

## 15. VPT LOANS

The following table lists the Company's outstanding loans and commitments for funding development and construction of various proton therapy centers:

	January 1, 2016		October 2, 2015	
	Balance	Commitment	Balance	Commitment
(In millions)				
Long-term notes receivable <sup>(1)</sup> :				
NYPC loan	\$20.8	\$70.7	\$18.7	\$72.8
MPTC loan	12.2	22.8	12.2	22.8
	\$33.0	\$93.5	\$30.9	\$95.6
Available-for-sale Securities <sup>(1)</sup> :				
CPTC loans	\$86.7	\$3.5	\$83.9	\$—
	\$86.7	\$3.5	\$83.9	\$—

<sup>(1)</sup> Included in other assets on the Company's Condensed Consolidated Balance Sheets.

## New York Proton Center ("NYPC") Loan

In July 2015, the Company, through one of its subsidiaries, committed to loan up to \$91.5 million to MM Proton I, LLC in connection with a purchase agreement to supply a proton system to equip NYPC. The commitment includes a \$73.0 million "Senior First Lien Loan" with a six-year term at 9% interest and an \$18.5 million "Subordinate Loan" with a six-and-a-half-year term at up to 13.5% interest. The Company's entire commitment of the Subordinate Loan was drawn down in fiscal year 2015. The Company expects the remaining draw downs of the Senior First Lien Loan to take place primarily through fiscal year 2018. Other lenders participating in the NYPC loans include J.P. Morgan and

an affiliate of The Goldman Sachs Group, Inc. The Senior First Lien Loan is collateralized by all of the assets of the NYPC.

VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

Maryland Proton Therapy Center ("MPTC") Loan

In May 2015, the Company, through one of its subsidiaries, committed to loan up to \$35.0 million to MPTC, which included rolling over an existing loan for \$10.0 million plus \$2.2 million of previously accrued interest. The Company had previously entered into an agreement with MPTC to supply it with a proton system. Varian's commitment is in the form of a subordinated loan that is due, with accrued interest, in three annual payments from 2020 to 2022. The Company's outstanding commitment under the loan to MPTC is to be paid in four installments of \$5.7 million each on June 30, 2016, September 30, 2016, December 30, 2016 and March 31, 2017. The interest on the loan accrues at 12%. As of January 1, 2016 and October 2, 2015, the Company had recorded \$24.0 million and \$28.6 million in accounts receivable from MPTC, respectively, which included unbilled accounts receivable.

CPTC Loans

As of October 2, 2015, the Company had loaned \$73.5 million under a Tranche A loan and \$10.4 million under a Tranche B loan to CPTC to fund the development, construction and initial operations of the Scripps Proton Therapy Center in San Diego, California under a loan agreement with ORIX and J.P. Morgan. ORIX is the loan agent for this facility and, along with CPTC and Scripps, has budgetary approval authority for the Scripps Proton Therapy Center. In November 2015, ORIX, J.P. Morgan and the Company (collectively the "Lenders") and CPTC entered into a forbearance agreement whereby the lenders will not enforce their rights to principal and interest payments until April 2017, subject to CPTC maintaining certain covenants and achieving certain targets, with additional extensions through September 2017 based on hitting additional targets largely around patient volume and cash flow. In connection with the forbearance agreement the Lenders agreed to make available up to an additional \$9.7 million of loan proceeds (based on their pro-rata share of the existing loan) with terms similar to the Tranche A loan for additional working capital needs; the Company's proportionate share of this commitment is \$4.4 million ("Tranche C loan") and is expected to be drawn down during fiscal year 2016. There were no other significant changes to the loan agreements. The Tranche A, Tranche B and Tranche C loans are collectively, referred to as the "CPTC Loans." As of January 1, 2016, the Company had loaned \$75.1 million under the Tranche A loan, \$10.7 million under the Tranche B loan and \$0.9 million under the Tranche C loan and no amounts were available for draw down under the Tranche A and Tranche B loans.

The amounts loaned under the CPTC Loans include accrued interest. ORIX has the option to purchase the Company's share of the CPTC loans at par. The CPTC loans meet the definition of a debt security and therefore are accounted for as available-for-sale securities and recorded at fair value as of January 1, 2016 and October 2, 2015. The Company's CPTC loans are included in other assets on the Company's Condensed Consolidated Balance Sheets as of January 1, 2016 and October 2, 2015 because the Company did not expect to be repaid and did not intend to sell all or a portion of its CPTC loans in the next twelve months. The Tranche B loan is subordinated to the Tranche A loan in the event of default, but otherwise has the same terms as the Tranche A loan. The CPTC Loans are collateralized by all of the assets of the Scripps Proton Therapy Center. The CPTC Loans mature in September 2017 and bear interest at the London Interbank Offer Rate ("LIBOR") plus 7.00% per annum with a minimum interest rate of 9.00% per annum. Interest only payments on the CPTC Loans were due monthly in arrears until January 1, 2015, at which time monthly payments based on amortization of the principal balance over a 15-year period at the above mentioned interest rate become due and payable. To date no amortizing principal payments have been made. The principal and interest payments are subject to the forbearance agreement mentioned above.

As of January 1, 2016 and October 2, 2015, the Company had recorded \$25.3 million and \$25.2 million in accounts receivable from CPTC, respectively, which included unbilled accounts receivable.

The Company has determined that MM Proton I, LLC, MPTC and CPTC are variable interest entities and that the Company holds a significant variable interest of each of the entities through its participation in the loan facilities and its agreements to supply and service the proton therapy equipment. The Company has concluded that it is not the primary beneficiary of any of these entities. The Company has no voting rights, has no approval authority or veto rights for these centers' budget, and does not have the power to direct patient recruitment, clinical operations and

management of these Centers, which the Company believes are the matters that most significantly affect their economic performance. The Company's exposure to loss as a result of its involvement with MM Proton I, LLC, MPTC and CPTC is limited to the carrying amounts of the above mentioned assets on its Condensed Consolidated Balance Sheets.

#### 16. SEGMENT INFORMATION

The Company's operations are grouped into two reportable operating segments: Oncology Systems and Imaging Components. The Company's Ginzton Technology Center ("GTC") and Varian Particle Therapy ("VPT") business are reflected in the "Other"

VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

category because these operating segments do not meet the criteria of a reportable operating segment. The 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 CODM allocates resources to and evaluates the financial performance of each operating segment primarily based on operating earnings.

Description of Segments

The Oncology Systems segment designs, manufactures, sells and services hardware and software products for treating cancer with conventional radiation therapy, and advanced treatments such as fixed field intensity-modulated radiation therapy ("IMRT"), image-guided radiation therapy ("IGRT"), volumetric modulated arc therapy ("VMAT"), stereotactic radiosurgery ("SRS"), stereotactic body radiotherapy ("SBRT") and brachytherapy. Products include linear accelerators, brachytherapy afterloaders, treatment simulation and verification equipment and accessories; as well as information management, treatment planning and image processing software. Oncology Systems' products enable radiation oncology departments in hospitals and clinics to perform conventional radiotherapy treatments and offer advanced treatments such as IMRT, IGRT, VMAT, SRS and SBRT, as well as to treat patients using brachytherapy techniques, which involve temporarily implanting radioactive sources. The Company's Oncology Systems products are also used by neurosurgeons to perform stereotactic radiosurgery. Oncology Systems' customers worldwide include university research and community hospitals, private and governmental institutions, healthcare agencies, physicians' offices and cancer care clinics.

The Imaging Components segment designs, manufactures, sells and services X-ray imaging components for use in a range of applications, including radiographic or fluoroscopic imaging, mammography, special procedures, computed tomography, computer-aided diagnostics and industrial applications. The Company provides a broad range of X-ray imaging components including X-ray tubes, flat panel digital image detectors, high voltage connectors, image processing software and workstations, ionization chambers and automatic exposure control systems. The Company's X-ray imaging components are sold to imaging system OEM customers that incorporate them into their medical diagnostic, dental, veterinary and industrial imaging systems to independent service companies and directly to end-users for replacement purposes. The Imaging Components segment also designs, manufactures, sells and services security and inspection products, which include Linatron® X-ray accelerators, imaging processing software and image detection products for security and inspection purposes, such as cargo screening at ports and borders and nondestructive examination in a variety of applications. The Company generally sells security and inspection products to OEM customers who incorporate its products into their inspection systems.

The Company's GTC and VPT business are reported together under the "Other" category.

The VPT business develops, designs, manufactures, sells and services products and systems for delivering proton therapy, a form of external beam radiotherapy using proton beams for the treatment of cancer.

GTC develops technologies that enhance the Company's current businesses or may lead to new business areas, including technology to improve radiation therapy and X-ray imaging, as well as other technology for a variety of applications.

## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

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

(In millions)	Three Months Ended	
	January 1, 2016	January 2, 2015
Revenues		
Oncology Systems	\$589.3	\$563.3
Imaging Components	141.4	166.0
Total reportable segments	730.7	729.3
Other	26.4	8.6
Total company	\$757.1	\$737.9
Operating Earnings (Loss)		
Oncology Systems	\$115.2	\$126.1
Imaging Components	25.2	41.2
Total reportable segments	140.4	167.3
Other	(12.3	) (13.6
Corporate	(11.4	) (24.2
Total company	\$116.7	\$129.5



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 as of January 1, 2016 and the related condensed consolidated statements of earnings, of comprehensive earnings and of cash flows for the three-month periods ended January 1, 2016 and January 2, 2015. These interim financial statements are the responsibility of the Company's management.

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

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

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of October 2, 2015, and the related consolidated statements of earnings and of comprehensive earnings, of stockholders' equity, and of cash flows for the year then ended (not presented herein), and in our report dated November 25, 2015, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of October 2, 2015, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PRICEWATERHOUSECOOPERS LLP  
PricewaterhouseCoopers LLP  
San Jose, California  
February 9, 2016

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

### Forward-Looking Statements

This Quarterly Report on Form 10-Q contains "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995, which provides a "safe harbor" for statements about future events, products and future financial performance that are based on the beliefs of, estimates made by, and information currently available to the management of Varian Medical Systems, Inc. ("VMS") and its subsidiaries (collectively "we," "our" or the "Company"). The outcome of the events described in these forward-looking statements is subject to risks and uncertainties. Actual results and the outcome or timing of certain events may differ significantly from those projected in these forward-looking statements or management's current expectations due to the factors cited in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A"), the Risk Factors listed under Part II, Item 1A of this Quarterly Report on Form 10-Q, and other factors described from time to time in our other filings with the Securities and Exchange Commission ("SEC"), or other reasons. For this purpose, statements concerning: industry or market segment outlook; market acceptance of or transition to new products or technology such as fixed field intensity-modulated radiation therapy, image-guided radiation therapy, stereotactic radiosurgery, volumetric modulated arc therapy, brachytherapy, software, treatment techniques, proton therapy and advanced X-ray tube and flat panel products; growth drivers; future orders, revenues, backlog, earnings or other financial results; and any statements using the terms "believe," "expect," "anticipate," "can," "should," "would," "could," "estimate," "may," "intend," "potential," and "possible" or similar statements are forward-looking statements that involve risks and uncertainties that could cause our actual results and the outcome and timing of certain events to differ materially from those projected or management's current expectations. 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

Our operations are currently grouped into two reportable operating segments: Oncology Systems and Imaging Components. Our Ginzton Technology Center ("GTC") and Varian Particle Therapy ("VPT") business are reflected in the "Other" category because these operating segments do not meet the criteria of a reportable operating segment. The operating segments were determined based on how our Chief Executive Officer, who is our Chief Operating Decision Maker ("CODM"), views and evaluates our operations. The CODM allocates resources to and evaluates the financial performance of each operating segment primarily based on operating earnings.

Total revenues increased 3%, gross margin decreased 3.4 percentage points, net earnings attributable to Varian decreased 5%, and net earnings per diluted share decreased 1%, in the first quarter of fiscal year 2016, compared to the year-ago period. Operating expenses included restructuring charges of \$4.8 million and \$10.5 million in the first quarter of fiscal year 2016 and 2015, respectively.

Gross orders decreased 5% in Oncology Systems and decreased 22% in Imaging Components in the first quarter of fiscal year 2016, compared to the year-ago period. Our backlog at January 1, 2016 was 7% higher than at the end of the first quarter of fiscal year 2015.

In order to assist with the assessment of how our underlying businesses performed, we compare the percentage change in revenues and gross orders from one period to another, excluding the effect of foreign currency fluctuations (i.e., using constant currency exchange rates). To present this information on a constant currency basis, we convert current period revenues and gross orders in currencies other than U.S. Dollars into U.S. Dollars using the comparable prior period's average exchange rate.

The U.S. Dollar strengthened against the Euro, the Japanese Yen and other foreign currencies in the first quarter of fiscal year 2016, compared to the year-ago period, which had a significant unfavorable impact on our revenues and gross orders. Due to the unfavorable foreign currency exchange rate fluctuations, total revenues and Oncology Systems gross orders were negatively impacted in the first quarter of fiscal year 2016 by approximately \$29 million and \$21 million, respectively. In the first quarter of fiscal year 2016, our total revenues and Oncology Systems gross orders increased 7% and decreased 1% in constant currency, compared to the year-ago period, respectively. We expect

that significant fluctuations of the Euro, the Japanese Yen and other foreign currencies against the U.S. Dollar will continue to cause variability in our financial performance.

In December 2015, the U.S. President signed into law the Protecting Americans from Tax Hikes Act of 2015 ("PATH Act"), which suspended the 2.3% medical device excise tax implemented as part of the Affordable Care Act for a two-year period through December 31, 2017. We expect the suspension to have a positive impact on our gross margin for fiscal years 2016 and 2017. Additionally, the PATH Act permanently extended the research and development ("R&D") tax credit, which we also expect will have a positive impact on our effective tax rate.

Oncology Systems. Our largest business segment is Oncology Systems, which designs, manufactures, sells and services hardware and software products for treating cancer with conventional radiotherapy and advanced treatments such as, intensity-modulated radiation therapy ("IMRT"), image-guided radiation therapy ("IGRT"), volumetric modulated arc therapy ("VMAT"), stereotactic radiotherapy, stereotactic body radiotherapy and brachytherapy, as well as informatics software for information management, clinical knowledge exchange, patient care management, practice management and decision-making support for comprehensive cancer clinics, radiotherapy centers and medical oncology practices.

Our primary goal in the Oncology Systems business is to promote the adoption of more advanced and effective cancer treatments. In our view, the fundamental market forces that drive long-term growth in our Oncology Systems business are the rise in cancer cases; technology advances and product developments that are leading to improvements in patient care; customer demand for the more advanced and effective cancer treatments that we enable; competitive conditions among hospitals and clinics to offer such advanced treatments; continued improvement in safety and cost efficiency in delivering radiation therapy; and underserved medical needs outside of the United States. Over the last few years, we have seen a greater percentage of Oncology Systems gross orders and revenues coming from emerging markets within our international region, which typically purchase lower-priced products, which generally have lower gross margin percentages compared to developed markets. We have also seen an increased portion of gross orders and revenues coming from services and software licenses, both of which have higher gross margin percentages than our hardware products. We have been investing a higher portion of our Oncology Systems research and development budget in software and software-related products.

The radiation oncology market in North America is largely characterized by replacements of older machines, with periodic increases in demand driven by the introduction of new technologies. Reimbursement rates in the United States have generally supported a favorable return on investment for the purchase of new radiotherapy equipment. While we believe that improved product functionality, greater cost-effectiveness and prospects for better clinical outcomes with new capabilities such as IMRT, IGRT and VMAT tend to drive demand for radiotherapy products, large changes in reimbursement rates or reimbursement structure can affect customer demand and cause market shifts. We do not know what impact the Patient Protection and Affordable Care Act (the "Affordable Care Act") in the United States will have on long-term growth or demand for our products and services. We believe, however, that growth of the radiation oncology market in the United States is being impacted as customers' decision-making processes are complicated by the uncertainties surrounding the Affordable Care Act and reimbursement rates for radiotherapy and radiosurgery, and that this uncertainty will likely continue during fiscal year 2016 and result in a high degree of variability of gross orders and revenues from quarter-to-quarter. We also believe that the Affordable Care Act, Accountable Care Organizations and bundled payment arrangements are causing healthcare providers to re-evaluate their business models and we are seeing increased consolidation of hospitals and clinics and more integration of systems and equipment across multi-site healthcare networks, which is impacting transaction size, timing and purchasing processes, and also contributing to the increased business variability.

In the radiation oncology markets outside of North America, we expect the long-term market growth of our EMEA region will be mixed. In APAC, we expect China to lead longer term regional growth, off-setting a slower Japanese market. Our long-term outlook for Latin America remains healthy. Overall, we believe the longer-term global radiation oncology market can grow, on average and in constant currencies, in the mid-single-digit range.

In the first quarter of fiscal year 2016, Oncology Systems revenues increased 5% and gross margin decreased by 3.4 percentage points compared to the year-ago period.

In the first quarter of fiscal year 2016, Oncology Systems gross orders decreased 5%, compared to the year-ago period, primarily due to a decrease of 11% in gross orders from our international regions, partially offset by an increase of 2% in gross orders from North America. On a constant currency basis, Oncology Systems international gross orders decreased 4% in the first quarter of fiscal year 2016, compared to the year-ago period.

Imaging Components. Our Imaging Components business segment designs, manufactures, sells and services X-ray imaging components for use in a range of applications, including radiographic or fluoroscopic imaging, mammography, special procedures, computed tomography, computer-aided diagnostics industrial applications. We provide a broad range of X-ray imaging components including X-ray tubes, flat panel digital image detectors, high

voltage connectors, image processing software and workstations, ionization chambers and automatic exposure control systems. Our Imaging Components business segment also designs, manufactures, sells and services security and inspection products, which include Linatron® X-ray accelerators, imaging processing software and image detection products for security and inspection purposes, such as cargo screening at ports and borders and nondestructive examination in a variety of applications. We continue to view the long-term driver for this business to be the ongoing success of key X-ray imaging original equipment manufacturers (“OEMs”) that incorporate our products into their medical diagnostic, dental, veterinary, security and industrial imaging systems. Orders and revenues for our security and inspection products have been and may continue to be unpredictable as governmental agencies

may place large orders with us or our OEM customers in a short time period, and then may not place any orders for a long time period thereafter.

Our success in Imaging Components depends upon our ability to anticipate changes in our markets, the direction of technological innovation and the demands of our customers. A significant portion of our Imaging Components customers are outside of the United States and therefore the demand for Imaging Components products continue to be negatively impacted by pricing pressures resulting from the strengthening of the U.S. Dollar. Because the products in this business are generally priced in U.S. Dollars, some customers have asked for additional discounts, delayed purchasing decisions, or moved to in-sourcing supply of such components or migrated to lower cost alternatives. We expect that a strong U.S. Dollar will continue to negatively impact demand and pricing for Imaging Component products. The market for border protection systems has slowed significantly and end customers, particularly in oil-based economies and war zones in which we have a significant customer base, are delaying tenders, resulting in a decline in the demand for security and inspection products which is expected to continue.

In the first quarter of fiscal year 2016, Imaging Components revenues, gross orders, and gross margin decreased by 15%, 22% and 1.8 percentage points, respectively, compared to the year-ago period.

Other. The "Other" category is comprised of VPT and the operations of the GTC.

VPT develops, designs, manufactures, sells and services products and systems for delivering proton therapy, another form of external beam radiotherapy using proton beams, for the treatment of cancer. Our current focus is bringing our expertise in traditional radiation therapy to proton therapy to improve its clinical utility and to reduce its cost of treatment per patient, so that it is more widely accepted and deployed. Orders and revenues for our VPT products have been and may continue to be subject to significant variability due to the size of each individual transaction, and the timing of each transaction may be impacted by numerous factors, including items outside of our control such as customer project financing.

GTC, our scientific research facility, develops technologies that enhance our current businesses or may lead to new business areas, including technology to improve radiation therapy and X-ray imaging, as well as other technology for a variety of applications, including security and cargo screening. GTC is also actively engaged in searching for chemical or biological agents that work synergistically with radiation to improve treatment outcomes.

In the first quarter of fiscal year 2016, the "Other" category revenues increased \$17.8 million and gross orders increased \$10.9 million compared to 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 Quarterly Report on Form 10-Q and the Consolidated Financial Statements and the Notes to the Consolidated Financial Statements and the related Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended October 2, 2015 (the "2015 Annual Report"), as well as the Risk Factors contained in Part II, Item 1A of this Quarterly Report on Form 10-Q, and other information provided from time to time in our other filings with the SEC.

#### Critical Accounting Estimates

The preparation of our financial statements and related disclosures in conformity with accounting principles generally accepted in the United States ("GAAP") requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and assumptions are based on historical experience and on various other factors that we believe are reasonable under the circumstances. We periodically review our accounting policies, estimates and assumptions and make adjustments when facts and circumstances dictate. In addition to the accounting policies that are more fully described in the Notes to the Consolidated Financial Statements included in our 2015 Annual Report on Form 10-K, we consider the critical accounting policies described below to be affected by critical accounting estimates. Our critical accounting policies that are affected by accounting estimates include revenue recognition, share-based compensation expense, valuation of allowance for doubtful accounts, impairment of investments and allowance for notes receivable, valuation of inventories, assessment of recoverability of goodwill and intangible assets, valuation of warranty obligations, assessment of loss contingencies, valuation of defined benefit pension and post-retirement benefit plans, valuation of derivative instruments, and taxes on earnings. Such accounting policies require us to use judgments, often as a result of the need to make estimates and assumptions

regarding matters that are inherently uncertain, and actual results could differ materially from these estimates. For a discussion of how these estimates and other factors may affect our business, see Part II, Item 1A, “Risk Factors.”

### Revenue Recognition

Our revenues are derived primarily from the sale of hardware and software products, and services from our Oncology Systems, Imaging Components and VPT businesses. We recognize revenues net of any value added or sales tax and net of sales discounts.

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

The allocation of consideration in a multiple element arrangement is affected by the determination of whether any software deliverables that function together with other hardware components to deliver the hardware products' essential functionality are considered as non-software products for purpose of revenue recognition. The allocation of consideration to each non-software deliverable is based on the assumptions we use to establish its selling price, which are based on vendor-specific objective evidence ("VSOE") of selling price, if it exists, otherwise, third-party evidence of selling price, if it exists, and, if not, on estimated selling prices. In addition, the allocation of consideration to each software deliverable in a multiple element arrangement is affected by our judgment as to whether VSOE of its fair value exists in these arrangements.

Changes to the elements in an arrangement and the amounts allocated to each element could affect the timing and amount of revenue recognition. Revenue recognition also depends on the timing of shipment, readiness of customers' facilities for installation, installation requirements, availability of products or customer acceptance terms. If shipments or installations 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.

Service revenues include revenues from hardware service contracts, software service agreements, bundled support arrangements, paid services and trainings, and parts that are sold by the service department. Revenues allocated to service contracts are generally recognized ratably over the period of the related contracts.

In addition, revenues related to proton therapy systems and proton therapy system commissioning contracts are recognized in accordance with contract accounting. We recognize contract revenues under the percentage-of-completion method which are based on contract costs incurred to date compared with total estimated contract costs. Changes in estimates of total contract revenue, total contract cost or the extent of progress towards completion are recognized in the period in which the changes in estimates are identified. Estimated losses on contracts are recognized in the period in which the loss is identified. In circumstances in which the final outcome of a contract cannot be precisely estimated but a loss on the contract is not expected, we recognize revenues under the percentage-of-completion method based on a zero profit margin until more precise estimates can be made. If and when we can make more precise estimates, revenues and costs of revenues are adjusted in the same period. Because the percentage-of-completion method involves considerable use of estimates in determining revenues, costs and profits and in assigning the dollar amounts to relevant accounting periods, and because the estimates must be periodically reviewed and appropriately adjusted, if our estimates prove to be inaccurate or circumstances change over time, we may be forced to adjust revenues or even record a contract loss in later periods.

### Share-based Compensation Expense

We grant restricted stock units, deferred stock units, performance units, and stock options to employees and permit employees to purchase shares under the VMS employee stock purchase plan. We value our stock options granted and the option component of the shares of VMS common stock purchased under the employee stock purchase plan using the Black-Scholes option-pricing model. We value our performance units using the Monte Carlo simulation model. The determination of fair value of share-based payment awards on the date of grant under both the Black-Scholes option-pricing model and the Monte Carlo simulation model is affected by VMS's stock price, as well as the input of other subjective assumptions, including the expected terms of share-based awards and the expected price volatilities of shares of VMS common stock and peer companies that are used to assess certain performance targets over the expected term of the awards, and the expected dividend yield of shares of VMS common stock.

The expected term of our stock options is based on the observed and expected time to post-vesting exercise and post-vesting cancellations of stock options by our employees. We use a blended volatility in deriving the expected



volatility assumption for our stock options. Blended volatility represents the weighted average of implied volatility and historical volatility. Implied volatility is derived based on traded options on VMS common stock. Implied volatility is weighted in the calculation of blended volatility based on the ratio of the term of the exchange-traded options to the expected terms of the employee stock options.

Historical volatility represents the remainder of the weighting. Our decision to incorporate implied volatility was based on our assessment that implied volatility of publicly traded options on VMS common stock is reflective of market conditions and is generally reflective of both historical volatility and expectations of how future volatility will differ from historical volatility. In determining the extent of use of implied volatility, we considered: (i) the volume of market activity of traded options; (ii) the ability to reasonably match the input variables of traded options to those of stock options granted by us, including the date of grant; (iii) the similarity of the exercise prices; and (iv) the length of term of traded options. After considering the above factors, we determined that we could not rely exclusively on implied volatility based on the fact that the term of VMS exchange-traded options is less than one year and that it is different from the expected terms of the stock options we grant. Therefore, we believe a combination of the historical volatility over the expected terms of the stock options we grant and the implied volatility of exchange-traded options best reflects the expected volatility of VMS common stock. In determining the grant date fair value of our performance units, historical volatilities of shares of VMS common stock, as well as the shares of common stock of peer companies, were used to assess certain performance targets. The risk-free interest rate assumption is based upon observed interest rates appropriate for the term of our stock awards. The dividend yield assumption is based on our history and expectation of no dividend payouts. If factors change and we employ different assumptions in future periods, the compensation expense that we record may differ significantly from what we have recorded in the current period. In addition, we are required to estimate the expected forfeiture rate, as well as the probability that certain performance conditions that affect the vesting of performance units will be achieved, and recognize expense only for those awards expected to vest. If the actual forfeiture rate and/or the actual number of performance units that vest based on achievement of performance conditions are materially different from our estimates, the share-based compensation expense could be significantly different from what we have recorded in the current period.

#### Allowance for Doubtful Accounts

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

#### Impairment of Investments and Allowance for Notes Receivable

We recognize an impairment charge when the declines in the fair values of our available-for-sale investments below their cost basis are determined to be other than temporary impairments ("OTTI"). Our available-for-sale investments primarily include CPTC loans. We monitor our available-for-sale investments for possible OTTI on an ongoing basis. When there has been a decline in fair value of a debt security below the amortized cost basis, we recognize OTTI if: (i) we have the intent to sell the security; (ii) it is more likely than not that we will be required to sell the security before recovery of the entire amortized cost basis; or (iii) we do not expect to recover the entire amortized cost basis of the security. We assess the fair value of the CPTC loans, which is classified in the level 3 fair value hierarchy based on the income approach by using the discounted cash flow model with key assumptions that include discount rates corresponding to the terms and risks associated with the loans to CPTC (see Note 3, "Fair Value" of the Notes to the Condensed Consolidated Financial Statements).

We also have investments in privately-held companies, some of which are in the startup or development stages. We monitor these investments for events or circumstances indicative of potential impairment, and we make appropriate reductions in carrying values if we determine that an impairment charge is required, based primarily on the financial condition, near-term prospects and recent financing activities of the investee. These investments are inherently risky because the markets for the technologies or products these companies are developing are typically in the early stages and may never materialize.

At times, we advance notes to third parties, including our customers. We assess these notes for collectibility and regularly review them for allowance by considering internal factors such as historical experience, credit quality, age of the receivable balances as well as external factors such as economic conditions that may affect the note holder's ability to pay.

Our ongoing consideration of all the factors described above could result in impairment charges in the future, which could adversely affect our operating results.

### Inventories

Our inventories include high technology parts and components that are highly specialized in nature and that are subject to rapid technological obsolescence. We have programs to minimize the required inventories on hand and we regularly review inventory quantities on hand and on order 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. Our future operating performance will be impacted by the future amortization of these acquired intangible assets and potential impairment charges related to these intangibles or to goodwill if indicators of impairment exist. The allocation of the purchase price from business acquisitions to goodwill and intangible assets could have a significant impact on our future operating results. In addition, the allocation of the purchase price of the acquired businesses to goodwill and intangible assets requires us to make significant estimates and assumptions, including estimates of future cash flows expected to be generated by the acquired assets and the appropriate discount rate for those cash flows. Should conditions differ from management's estimates at the time of the acquisition, material write-downs of intangible assets and/or goodwill may be required, which would adversely affect our operating results.

We evaluate goodwill for impairment at least annually or whenever an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The evaluation includes consideration of qualitative factors including industry and market considerations, overall financial performance, and other relevant events and factors affecting the reporting unit. If we determine that a quantitative analysis is necessary, the impairment test for goodwill is a two-step process. Step one consists of a comparison of the fair value of a reporting unit against its carrying amount, including the goodwill allocated to each reporting unit. We determine the fair value of our reporting units based on a combination of income and market approaches. The income approach is based on the present value of estimated future cash flows of the reporting units and the market approach is based on a market multiple calculated for each business unit based on market data of other companies engaged in similar business. If the carrying amount of the reporting unit is in excess of its fair value, step two requires the comparison of the implied fair value of the reporting unit's goodwill against the carrying amount of the reporting unit's goodwill. Any excess of the carrying value of the reporting unit's goodwill over the implied fair value of the reporting unit's goodwill is recorded as an impairment loss. The impairment test for intangible assets with indefinite useful lives, if any, consists of a comparison of fair value to carrying value, with any excess of carrying value over fair value being recorded as an impairment loss.

We have four reporting units with goodwill: (i) Oncology Systems, (ii) X-ray tubes and flat panel products, (iii) Security and inspection products, and (iv) VPT. For all four reporting units, based upon the most recent annual goodwill analysis that we performed as of the end of the third quarter of fiscal year 2015, either step one of the impairment test was not completed based on evaluation of qualitative factors or, for those which step one was completed, the fair value was substantially in excess of carrying value. However, significant changes in our projections about our operating results or other factors could cause us to make interim assessments of impairments in any quarter that could result in some or all of the goodwill being impaired. For our VPT reporting unit in particular, which had \$48.3 million in goodwill as of January 1, 2016, our estimates as to future operating results include certain assumptions about factors that cannot be predicted with certainty, including future market conditions, revenue growth rates, and operating margins.

We will continue to make assessments of impairment on an annual basis or more frequently if indicators of potential impairment arise.

### Warranty Obligations

We warrant most of our products for a specific period of time, usually 12 months from installation, against material defects. We provide for the estimated future costs of warranty obligations in cost of revenues when the related revenues are recognized. The accrued warranty costs represent our best estimate at the time of sale of the total costs

that we will incur to repair or replace product parts that fail while still under warranty. The amount of accrued estimated warranty costs obligation for established products is primarily based on historical experience as to product failures adjusted for current information on repair costs. For new products, estimates will include historical experience of similar products, as well as reasonable allowance for start-up expenses. Actual warranty costs could differ from the estimated amounts. On a quarterly basis, we review the accrued balances

of our warranty obligations and update the historical warranty cost trends, if required. If we were required to accrue additional warranty costs in the future, it would have a negative effect on our operating results.

#### Loss Contingencies

From time to time, we are a party to or otherwise involved in legal proceedings, claims and government inspections or investigations or other legal matters, both inside and outside the United States, arising in the ordinary course of our business or otherwise. We accrue amounts, to the extent they can be reasonably estimated, that we believe are adequate to address any liabilities related to legal proceedings and other loss contingencies that we believe will result in a probable loss. Such matters are subject to many uncertainties, outcomes are not predictable with assurance, and actual liabilities could significantly exceed our estimates of potential liabilities. In addition, we are subject to a variety of environmental laws around the world. Those laws regulate multiple aspects of our operations, including the handling, storage, transport and disposal of hazardous substances. They impose costs on our operations. In connection with our past and present operations and facilities, we record environmental remediation liabilities when we conclude that environmental assessments or remediation efforts are probable and we believe we can reasonably estimate the costs of those efforts. Our accrued environmental costs represent our best estimate of the total costs of assessments and remediation and the time period over which we expect to incur those costs. We review these accrued balances quarterly. If we were required to increase or decrease the accrued environmental costs in the future, it would adversely or favorably impact our operating results.

#### Defined Benefit Pension and Post-Retirement Benefit Plans

We sponsor seven defined benefit pension plans in Germany (where we have three defined benefit pension plans), Japan, Switzerland, the Philippines and the United Kingdom covering employees who meet the applicable eligibility requirements in these countries. Several statistical and other factors that attempt to anticipate future events are used in calculating the expenses and liabilities related to the aforementioned plans. These factors include assumptions about the discount rate, expected return on plan assets, and rate of future compensation increases, all of which we determine within certain guidelines. In addition, we also use assumptions, such as withdrawal and mortality rates, to calculate the expenses and liabilities. The actuarial assumptions we use are long-term assumptions and may differ materially from actual experience particularly in the short term due to changing market and economic conditions and changing participant demographics. These differences may have a significant impact on the amount of defined benefit pension plan expenses we record.

The expected rates of return on the various defined benefit pension plans' assets are based on the asset allocation of each plan and the long-term projected return on those assets. The discount rate enables us to state expected future cash flows at a present value on the measurement date. The discount rates used for defined benefit plans are primarily based on the current effective yield of long-term corporate bonds that are of high quality with satisfactory liquidity and credit rating with durations corresponding to the expected durations of the benefit obligations. A change in the discount rate may cause the present value of benefit obligations to change significantly.

#### Valuation of Derivative Instruments

We use foreign currency forward contracts to reduce the effects of currency rate fluctuations on sales transactions denominated in foreign currencies and on assets and liabilities denominated in foreign currencies. These foreign currency forward contracts are derivative instruments and are measured at fair value. There are three levels of inputs that may be used to measure fair value (see Note 3, "Fair Value" of the Notes to the Condensed Consolidated Financial Statements). The fair value of foreign currency forward contracts are calculated primarily using Level 2 inputs, which include currency spot and forward rates, interest rate and credit or non-performance risk. The spot rate for each currency is the same spot rate used for all balance sheet translations at the measurement date and sourced from our major trading banks. The forward point values for each currency and the London Interbank Offered Rate ("LIBOR") to discount assets and liabilities are interpolated from commonly quoted broker services. One year credit default swap spreads of the counterparty at the measurement date are used to adjust derivative assets, all of which mature in 13 months or less, for non-performance risk. We are required to adjust derivative liabilities to reflect the potential non-performance risk to lenders based on our incremental borrowing rate. Each contract is individually adjusted using the counterparty credit default swap rates (for net assets) or our borrowing rate (for net liabilities). The use of Level 2 inputs in determining fair values requires certain management judgment and subjectivity. Changes to

these Level 2 inputs could have a material impact on the valuation of our derivative instruments, as well as on our result of operations. There were no transfers of assets or liabilities between fair value measurement levels during the first quarter of fiscal years 2016 and 2015.

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

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

Our foreign earnings 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 foreign subsidiaries do business. In addition, a decrease in the percentage of our total earnings from our foreign countries, or a change in the mix of foreign countries among particular tax jurisdictions could increase or decrease our effective tax rate. Our current effective tax rate does not assume U.S. taxes on certain undistributed profits of certain foreign subsidiaries. These earnings could become subject to incremental foreign withholding or U.S. federal and state taxes should they either be deemed or actually remitted to the United States.

## Results of Operations

### Fiscal Year

Our fiscal year is the 52- or 53-week period ending on the Friday nearest September 30. Fiscal year 2016 is the 52-week period ending September 30, 2016, and fiscal year 2015 was the 53-week period ended October 2, 2015. The fiscal quarter ended January 1, 2016 was a 13-week period and the fiscal quarter ended January 2, 2015 was a 14-week period.

### Discussion of Results of Operations for the First Quarter of Fiscal Year 2016 Compared to the First Quarter of Fiscal Year 2015

#### Total Revenues

#### Revenues by sales classification

	Three Months Ended			Percent Change
	January 1, 2016	January 2, 2015		
(Dollars in millions)				
Product	\$500.5	\$475.8	5	%
Service	256.6	262.1	(2	)%
Total Revenues	\$757.1	\$737.9	3	%
Product as a percentage of total revenues	66	% 64	%	
Service as a percentage of total revenues	34	% 36	%	



Total revenues increased in the first quarter of fiscal year 2016, compared to the year-ago period, due to increases in revenues from Oncology Systems and the "Other" category, partially offset by a decrease in revenues from Imaging Components.

Product revenues increased in the first quarter of fiscal year 2016, compared to the year-ago period, due to increases in revenues from Oncology Systems and the "Other" category, partially offset by a decrease in revenues from Imaging Components.

Service revenues decreased in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to a decrease in revenues from Oncology Systems, partially offset by an increase in revenues from Imaging Components.

#### Revenues by region

Revenues by region	Three Months Ended					
(Dollars in millions)	January 1, 2016	January 2, 2015	Percent Change		Constant Currency <sup>(1)</sup>	
Americas	\$348.5	\$370.7	(6	)%	(6	)%
EMEA	270.1	209.2	29	%	40	%
APAC	138.5	158.0	(12	)%	(9	)%
Total Revenues	\$757.1	\$737.9	3	%	7	%
North America	\$324.6	\$355.3	(9	)%	(9	)%
International <sup>(2)</sup>	432.5	382.6	13	%	21	%
Total Revenues	\$757.1	\$737.9	3	%	7	%
North America as a percentage of total revenues	43	%	48	%		
International as a percentage of total revenues	57	%	52	%		

(1) Constant currency is the percent change excluding the effect of foreign currency fluctuations against the U.S. Dollar.

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

The Americas revenues decreased in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to a decrease in revenues from Oncology Systems, and to a lesser extent, a decrease in revenues from Imaging Components, partially offset by an increase in revenues from the "Other" category.

EMEA revenues increased in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to an increase in revenues from Oncology Systems, and to a lesser extent, increases in revenues from the "Other" category and Imaging Components.

APAC revenues decreased in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to a decrease in revenues from Imaging Components, partially offset by an increase in revenues from Oncology Systems.

#### Oncology Systems Revenues

##### Revenues by sales classification

Revenues by sales classification	Three Months Ended					
(Dollars in millions)	January 1, 2016	January 2, 2015	Percent Change		Constant Currency	
Product	\$343.0	\$308.8	11	%	15	%
Service	246.3	254.5	(3	)%	1	%
Total Oncology Systems Revenues	\$589.3	\$563.3	5	%	9	%
Product as a percentage of total Oncology Systems revenues	58	% 55	%			
Service as a percentage of total Oncology Systems revenues	42	% 45	%			
Oncology Systems revenues as a percentage of total revenues	78	% 76	%			

Oncology Systems product revenues increased in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to an increase in revenues from hardware products, and to a lesser extent, an increase in revenues from software licenses.

Oncology Systems service revenues decreased in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to unfavorable currency impacts and an extra week of operations during the first quarter of fiscal year 2015,

partially offset by increased customer adoption of service contracts as the warranty period on our TrueBeam systems expire and an increase in the number of customers as the installed base of our products continues to grow.

#### Revenues by region

Revenues by region	Three Months Ended					
(Dollars in millions)	January 1, 2016	January 2, 2015	Percent Change		Constant Currency	
Americas	\$284.3	\$308.4	(8	)%	(7	)%
EMEA	212.6	167.8	27	%	37	%
APAC	92.4	87.1	6	%	13	%
Total Oncology Systems Revenues	\$589.3	\$563.3	5	%	9	%
North America	\$263.8	\$295.1	(11	)%	(10	)%
International	325.5	268.2	21	%	31	%
Total Oncology Systems Revenues	\$589.3	\$563.3	5	%	9	%
North America as a percentage of total Oncology Systems revenues	45	%	52	%		
International as a percentage of total Oncology Systems revenues	55	%	48	%		

The Americas Oncology Systems revenues decreased in the first quarter of fiscal year 2016, compared to the year-ago period, due to a decrease in product revenues, and to a lesser extent, a decrease in service revenues. Product revenues from The Americas region decreased due to a decrease in revenues from North American hardware products, and to a lesser extent, a decrease in revenues from North American software licenses, partially offset by increases in revenues from Latin American hardware products and software licenses.

EMEA Oncology Systems revenues increased in the first quarter of fiscal year 2016, compared to the year-ago period, due to an increase in product revenues, partially offset by a decrease in service revenues. Product revenues from the EMEA region increased due to an increase in volume from hardware products and the timing of shipments.

APAC Oncology Systems revenues increased in the first quarter of fiscal year 2016, compared to the year-ago period, due to an increase in product revenues. Product revenues from the APAC region increased primarily due to an increase in revenues from software licenses and hardware products.

The U.S. Dollar was stronger against the Euro, the Japanese Yen and other foreign currencies in the first quarter of fiscal year 2016, compared to the year-ago period. The overall fluctuations in currency exchange rates had a negative impact on the revenues of Oncology Systems during the first quarter of fiscal year 2016, as compared to the year-ago period.

Varying cycles of higher and lower revenues between the North American and international regions are impacted by regional influences, which recently have included government programs, economic and political instability in some countries, uncertainty created by health care reform (such as the excise tax on the sale of most medical devices, Medicare reimbursement rates and consolidation of free standing clinics in the United States), and different technology adoption cycles that are consistent with the gross order patterns. See further discussion of orders under "Gross Orders."

#### Imaging Components Revenues

##### Revenues by sales classification

(Dollars in millions)	Three Months Ended		Percent Change		
	January 1, 2016	January 2, 2015			
Product	\$133.2	\$159.8	(17)	)%	
Service	8.2	6.2	33	%	
Total Imaging Components Revenues	\$141.4	\$166.0	(15)	)%	
Product as a percentage of total Imaging Components revenues	94	% 96	%		
Service as a percentage of total Imaging Components revenues	6	% 4	%		
Imaging Components revenues as a percentage of total revenues	19	% 23	%		



Imaging Components product revenues decreased in the first quarter of fiscal year 2016, compared to the year-ago period, due to a decrease in revenues from X-ray flat panel and tube products, and to a lesser extent, a decrease in revenues from security and inspection products, partially offset by an increase in product revenues from acquisitions completed in the second half of fiscal year 2015. The decreases in revenues from X-ray flat panel and tube products were primarily due to pricing pressures resulting from the strengthening of the U.S. Dollar, customers migrating to lower cost alternatives, and the decision of a customer to in-source some of their X-ray flat panel products. In addition, lower purchases from a key customer with elevated X-ray tube inventory, due in part to longer tube life, also contributed to the declines in revenues. The decrease in revenues from security and inspection products was due to pricing pressures and delays in tenders in which our customers participate.

Imaging Components service revenues in the first quarter of fiscal years 2016 and 2015 were primarily attributed to our security and inspection products. The increase in Imaging Components service revenues in the first quarter of fiscal year 2016, compared to the year-ago period, was primarily due to additional service revenues from acquisitions completed in the second half of fiscal year 2015.

Because sales transactions in Imaging Components are generally denominated in U.S. Dollars, fluctuations in currency exchange rates did not have a material direct impact on Imaging Components international revenues. However, demand from X-ray flat tube and flat panel products and, consequently revenues, were negatively impacted by pricing pressures resulting from the strengthening of the U.S. Dollar against the Japanese Yen and the Euro in the first quarter of fiscal year 2016, compared to the year-ago period, which made our products relatively more expensive as compared to non-U.S. manufacturers and to customers outside the U.S.

Revenues by region	Three Months Ended			
	January 1, 2016	January 2, 2015	Percent Change	
(Dollars in millions)				
Americas	\$53.2	\$58.2	(9	)%
EMEA	42.0	37.0	14	%
APAC	46.2	70.8	(35	)%
Total Imaging Components Revenues	\$141.4	\$166.0	(15	)%
North America	\$49.8	\$56.0	(11	)%
International	91.6	110.0	(17	)%
Total Imaging Components Revenues	\$141.4	\$166.0	(15	)%
North America as a percentage of total Imaging Components revenues	35	% 34	%	
International as a percentage of total Imaging Components revenues	65	% 66	%	

The Americas Imaging Components revenues decreased in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to a decrease in revenues from X-ray flat panel products and to a lesser extent, a decrease in revenues from security and inspection products, partially offset by an increase in revenues from acquisitions completed in the second half of fiscal year 2015. The decrease in revenues from X-ray flat panel products was primarily due to a decision of a customer to in-source some of their X-ray flat panel products.

EMEA Imaging Components revenues increased in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to an increase in revenues from acquisitions completed in the second half of fiscal year 2015.

APAC Imaging Components revenues decreased in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to a decrease in revenues from X-ray tube and flat panel products. The decrease in revenues from X-ray tube and flat panel products was due to pricing pressures resulting from the strengthening of the U.S. Dollar. In addition, lower purchases from a key customer with elevated X-ray tube inventory, due in part to longer tube life, also contributed to the declines in revenues from X-ray tube products. The decrease in revenues from the APAC region was partially offset by an increase in revenues from acquisitions completed in the second half of fiscal year 2015.



# Other Revenues

## Revenues by sales classification

	Three Months Ended			
	January 1, 2016	January 2, 2015	Percent Change	
(Dollars in millions)				
Product	\$24.3	\$7.2	240	%
Service	2.1	1.4	46	%
Total Other Revenues	\$26.4	\$8.6	207	%
Other revenues as a percentage of total revenues	3	% 1	%	

Revenues in our "Other" category increased in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to an increase in VPT product revenues, resulting from continued production and installation of VPT projects that are in our backlog.

## Gross Margin

	Three Months Ended			
	January 1, 2016	January 2, 2015	Percent Change	
(Dollars in millions)				
Oncology Systems	\$248.6	\$256.7	(3	)%
Imaging Components	57.1	70.0	(18	)%
Other	4.0	0.3	n/m	
Gross margin	\$309.7	\$327.0	(5	)%

## Percentage by segment

Oncology Systems	42.2	% 45.6	%
Imaging Components	40.4	% 42.2	%
Total Company	40.9	% 44.3	%

n/m = not meaningful

Total gross margin percentage decreased in the first quarter of fiscal year 2016, compared to the year-ago period, due to decreases in Oncology Systems and Imaging Components gross margin percentages, and an increase in revenues in the "Other" category, which has a lower gross margin percentage. Total product gross margin percentage was 31.4% in the first quarter of fiscal year 2016, compared to 35.7% for the year-ago period. Total service gross margin percentage was 59.5% in the first quarter of fiscal year 2016, compared to 59.9% for the year-ago period.

Oncology Systems product gross margin percentage was 29.9% for the first quarter of fiscal year 2016, compared to 33.7% for the year-ago period. The decrease in product gross margin percentage was due to a shift to geographies which generally have lower margins and an unfavorable foreign currency impact. Oncology Systems service gross margin percentage was 59.2% for the first quarter of fiscal year 2016, compared to 60.0% for the year-ago period. The decrease in service gross margin percentage was due to an unfavorable foreign currency impact, partially offset by cost control measures.

Imaging Components gross margin percentage decreased in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to a decrease in gross margin from X-ray tube and flat panel products. The decrease in gross margin percentage from X-ray tube and flat panel products in the first quarter of fiscal year 2016, compared to the year-ago period, was primarily due to increased pricing pressures resulting from the strengthening of the U.S. Dollar and higher material costs in X-ray tube products, partially offset by productivity gains in X-ray flat panel products in the first quarter of fiscal year 2016.

## Research and Development

(Dollars in millions)	Three Months Ended			Percent Change	
	January 1, 2016	January 2, 2015			
Research and development	\$60.0	\$57.1		5	%
Research and development as a percentage of total revenues	8	% 8		%	

Research and development expenses increased \$2.9 million in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to an increase in expenses of \$1.5 million in Imaging Components and a \$1.2 million increase in the "Other" category. The \$1.5 million increase in Imaging Components was due to additional research and development expenses related to acquisitions completed in the second half of fiscal year 2015, partially offset by a reduction in research and development expenses for our X-ray tube and flat panel products.

## Selling, General and Administrative

(Dollars in millions)	Three Months Ended			Percent Change	
	January 1, 2016	January 2, 2015			
Selling, general and administrative	\$133.1	\$140.5		(5	)%
Selling, general and administrative as a percentage of total revenues	18	% 19		%	

Selling, general and administrative expenses decreased \$7.4 million in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to: a \$5.7 million decrease in restructuring charges; approximately \$4 million in favorable currency impact when foreign-currency denominated expenses were translated into U.S. dollars; and a \$3.9 million decrease in bad debt expense. These decreases were partially offset by a \$3.3 million increase in expenses from acquisitions completed in the second half of fiscal year 2015, and a \$2.1 million increase in legal expenses.

## Interest Income, Net

(Dollars in millions)	Three Months Ended			Percent Change	
	January 1, 2016	January 2, 2015			
Interest income, net	\$1.7	\$1.0		73	%

Interest income, net of interest expense, increased in the first quarter of fiscal year 2016, compared to the year-ago period, due to higher interest income primarily generated from our loans to fund the development and construction of various proton therapy centers, partially offset by a higher interest expense associated with increased borrowings from our credit facility.

## Taxes on Earnings

	Three Months Ended			Percent Change	
	January 1, 2016	January 2, 2015			
Effective tax rate	24.8	% 28.5		% (3.7	)%

Our effective tax rate decreased in the first quarter of fiscal year 2016, compared to the year ago period, primarily due to the geographic mix of earnings and the reinstatement of the federal R&D tax credit.

Our effective tax rate is impacted by the percentage of our total earnings that come from our international region, the mix of particular tax jurisdictions within our international region, changes in the valuation of our deferred tax assets or liabilities, and changes in tax laws or interpretations of those laws. We also expect that our effective tax rate may experience increased fluctuations from period to period. See Note 14, "Taxes on Earnings" of the Notes to the Consolidated Financial Statements in our 2015 Annual Report.



## Diluted Net Earnings Per Share

	Three Months Ended		
	January 1, 2016	January 2, 2015	Percent Change
Diluted net earnings per share	\$0.91	\$0.92	(1)%

The decrease in the diluted net earnings per share in the first quarter of fiscal year 2016, compared to the year-ago period, was due to a decrease in operating earnings offset by a reduction in the number of diluted shares of common stock outstanding due to stock repurchases and a decrease in the effective tax rate.

## Gross Orders

Total Gross Orders (by segment)	Three Months Ended		
	January 1, 2016	January 2, 2015	Percent Change
(Dollars in millions)			
Oncology Systems	\$532.6	\$561.7	(5)%
Imaging Components	127.1	162.7	(22)%
Other	12.3	1.4	790%
Total Gross Orders	\$672.0	\$725.8	(7)%

Gross orders are defined as the sum of new orders recorded during the period adjusted for any revisions to existing orders during the period. New orders are recorded for the total contractual amount, excluding certain pass-through items, once a written agreement for the delivery of goods or provision of services is in place and, for businesses other than VPT, when shipment of the product is expected to occur within two years, so long as any contingencies are deemed perfunctory. However, we will not record security and inspection products orders from governmental agencies with bid protest provisions until the expiration of the bid protest period. For our VPT business, we record orders when construction of the related proton therapy treatment center is reasonably expected to start within two years, but only if any contingencies are either deemed perfunctory or if the existence and nature of material contingencies is disclosed. However, we will not record VPT orders if there are major financing contingencies, if a substantial portion of the financing for the project is not reasonably assured or if customer board approval contingencies are pending. We perform a quarterly review to verify that outstanding orders remain valid.

Gross orders in any period may not be directly correlated to the level of revenues in any particular future quarter or period since the timing of revenue recognition will vary significantly based on the delivery requirements of individual orders, acceptance schedules and the readiness of individual customer sites for installation of our products. Moreover, certain types of orders, such as orders for software or newly introduced products in our Oncology Systems segment, typically take more time from order to completion of installation and acceptance than hardware or older products. Gross orders and revenues for our security and inspection products in our Imaging Components segment have been and may continue to be unpredictable as governmental agencies may place large orders with us or with our OEM customers over a short period of time and then may not place any orders for a long time period thereafter. Because an order for a proton therapy system can be relatively large, an order in one fiscal period will cause gross orders in our VPT business to vary significantly, making comparisons between fiscal periods more difficult. Furthermore, bid awards, primarily in our VPT business, may be subject to challenge by third parties, which can make these orders more unpredictable than other products.

## Oncology Systems Gross Orders

## Gross Orders by region

(Dollars in millions)	Three Months Ended			Constant	
	January 1, 2016	January 2, 2015	Percent Change	Currency	
Americas	\$282.7	\$274.7	3	%	3
EMEA	154.9	179.6	(14)	)%	(5)
APAC	95.0	107.4	(12)	)%	(7)
Total Oncology Systems Gross Orders	\$532.6	\$561.7	(5)	)%	(1)
North America	\$256.4	\$251.1	2	%	2
International	276.2	310.6	(11)	)%	(4)
Total Oncology Systems Gross Orders	\$532.6	\$561.7	(5)	)%	(1)

The Americas Oncology Systems gross orders increased in the first quarter of fiscal year 2016, compared to the year-ago period, due to an increase in gross orders from hardware products partially offset by a decrease in gross orders from software licenses.

EMEA Oncology Systems gross orders decreased in the first quarter of fiscal year 2016, compared to the year-ago period due to a decrease in gross orders from hardware products, and to a lesser extent, a decrease in gross orders from software licenses.

APAC Oncology Systems gross orders decreased in the first quarter of fiscal year 2016, compared to the year-ago period primarily due to a decrease in gross orders from hardware products.

The trailing 12 months growth in gross orders for Oncology Systems at the end of the first quarter of fiscal year 2016 and at the end of each of the previous three fiscal quarters were:

	January 1, 2016	October 2, 2015	July 3, 2015	April 3, 2015
Americas	2%	1%	8%	8%
EMEA	(5)%	—%	(3)%	(2)%
APAC	(5)%	—%	—%	(5)%
North America	4%	3%	6%	6%
International	(7)%	(2)%	1%	—%
Total Oncology Systems Gross Orders	(2)%	—%	3%	3%

Consistent with the historical pattern, we expect that Oncology Systems gross orders will continue to experience regional fluctuations, with an overall shift of gross orders towards international regions and emerging markets.

Oncology Systems gross orders are affected by foreign currency fluctuations. In addition, government programs that stimulate the purchase of healthcare products could affect the demand for our products from period to period, and could therefore make it difficult to compare our financial results.

## Imaging Components Gross Orders

## Gross Orders by region

(Dollars in millions)	Three Months Ended		
	January 1, 2016	January 2, 2015	Percent Change
Americas	\$43.1	\$49.4	(13)%
EMEA	43.0	33.4	29%
APAC	41.0	79.9	(49)%
Total Imaging Components Gross Orders	\$127.1	\$162.7	(22)%
North America	\$41.6	\$47.3	(12)%
International	85.5	115.4	(26)%
Total Imaging Components Gross Orders	\$127.1	\$162.7	(22)%

The Americas Imaging Components gross orders decreased in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to a decrease in gross orders from X-ray flat panel products. The decrease in gross orders from X-ray flat panel products was primarily due to a decision of a customer to in-source some of their X-ray flat panel products. The decrease in gross orders from The Americas region was partially offset by an increase in gross orders from acquisitions completed in the second half fiscal year 2015.

EMEA Imaging Components gross orders increased in the first quarter of fiscal year 2016, compared to the year-ago period primarily due to an increase in gross orders from X-ray flat panel products and from acquisitions completed in the second half of fiscal year 2015.

APAC Imaging Components gross orders decreased in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to a decrease in gross orders from X-ray flat panel products, and to a lesser extent, a decrease in gross orders from X-ray tube products. X-ray tube and flat panel products gross orders from the APAC region decreased in the first quarter of fiscal year 2016, compared to the year-ago period, primarily due to the timing of several large orders in X-ray flat panel products in the prior comparable period and elevated X-ray tube inventory at a key customer, due in part to longer tube life.

The difference in currency exchange rates between the U.S. Dollar and foreign currencies in the first quarter of fiscal year 2016, compared to the year-ago period, did not have a material impact on Imaging Components international orders because orders in Imaging Components are generally denominated in U.S. Dollars. However, overall, gross orders from Imaging Components in the first quarter of fiscal year 2016, compared to the year-ago period were impacted by the pricing pressures resulting from strengthening of the U.S. Dollar against the Japanese Yen and the Euro which caused a decline in demand for X-ray tube and flat panel products from some customers in APAC and EMEA.

## Other Gross Orders

The "Other" category gross orders increased in the first quarter of fiscal year 2016, compared to the year-ago period, due to an increase in product gross orders from VPT.

## Backlog

Backlog is the accumulation of all gross orders for which revenues have not been recognized and are still considered valid. Backlog also includes a small portion of billed service contracts that are included in deferred revenue. Backlog is stated at historical foreign currency exchange rates and revenue is released from backlog at current exchange rates, with any difference recorded as a backlog adjustment. Our backlog at January 1, 2016 was \$3.3 billion, including approximately \$325 million in VPT backlog, which was an increase of 7% over the backlog at January 2, 2015. Our Oncology Systems backlog at January 1, 2016 was 4% higher than the backlog at January 2, 2015, which reflected a 1% increase for the international region and a 7% increase for North America.

We perform a quarterly review to verify that outstanding orders in the backlog remain valid. Aged orders that are not expected to be converted to revenues are deemed dormant and are reflected as a reduction in the backlog amounts in the period identified. Backlog adjustments are comprised of dormancies, cancellations, foreign currency exchange rate adjustments,



backlog acquired from acquisitions, and other adjustments. In the first quarter of fiscal years 2016 and 2015, our backlog adjustments were \$54.6 million and \$33.8 million, respectively.

#### Liquidity and Capital Resources

Liquidity is the measurement of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, acquire businesses or make other investments or loans, repurchase shares of VMS common stock, and fund continuing operations and capital expenditures. Our sources of cash have included operations, borrowings, stock option exercises, and employee stock purchases. Our cash usage is actively managed on a daily basis to ensure the maintenance of sufficient funds to meet our needs.

#### Cash and Cash Equivalents

The following table summarizes our cash and cash equivalents:

(In millions)	January 1, 2016	October 2, 2015	Increase
Cash and cash equivalents	\$953.4	\$845.5	\$107.9

The increase in cash and cash equivalents in the first quarter of fiscal year 2016 was primarily due to \$232.5 million of net borrowings under our credit facility agreements, \$77.2 million of cash provided by operating activities and \$15.3 million of cash provided by stock option exercises and employee stock purchases. These increases were partially offset by \$192.1 million of cash used for the repurchase of shares of VMS common stock and \$27.3 million used for purchases of property, plant, and equipment.

At January 1, 2016, we had approximately \$20.5 million, or 2%, of cash and cash equivalents in the United States. Approximately \$932.9 million, or 98%, of cash and cash equivalents was held abroad and a portion of this amount could be subject to additional taxation if it were repatriated to the United States. As of January 1, 2016, most of our cash and cash equivalents that were held abroad were in U.S. Dollars and were primarily held as bank deposits. In addition to cash flows generated from operations, a significant portion of which are generated in the United States, we have used our credit facilities to meet our cash needs from time to time and expect to continue to do so in the future. Borrowings under our credit facilities may be used for working capital, capital expenditures, VMS share repurchases, acquisitions and other corporate purposes.

#### Cash Flows

(In millions)	Three Months Ended	
	January 1, 2016	January 2, 2015
Net cash flow provided by (used in):		
Operating activities	\$77.2	\$79.0
Investing activities	(24.3)	(25.6)
Financing activities	49.8	(7.3)
Effects of exchange rate changes on cash and cash equivalents	5.2	9.0
Net increase in cash and cash equivalents	\$107.9	\$55.1

Our primary cash inflows and outflows for the first quarter of fiscal year 2016, as compared to the first quarter of fiscal year 2015, were as follows:

In the first quarter of fiscal year 2016, we generated net cash from operating activities of \$77.2 million compared to \$79.0 million in the first quarter of fiscal year 2015. The \$1.8 decrease in net cash from operating activities in the first quarter of fiscal year 2016, compared to the year-ago period, was driven by a \$20.6 million decrease from non-cash items, and a \$4.3 million decrease in net earnings, partially offset by a \$23.1 million increase in net change from operating assets and liabilities (working capital items).

The major contributors to the net change in working capital items in the first quarter of fiscal year 2016 were as follows:

Accounts receivable increased \$29.5 million primarily due to timing of collections in Oncology Systems.

Prepaid expenses and other assets increased \$12.0 million mainly due to timing of payments for employee related costs and to suppliers.

Accounts payable decreased \$14.2 million mainly due to timing of payments processed.

Deferred revenues and advance payments from customers increased \$11.0 million due to receipts of down payments for orders for which revenues have not been recognized and due to the nature of contracts and timing of customer acceptances, primarily in Oncology Systems.

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, product installation or customer acceptance, accounts receivable collections, inventory management, and the timing and amount of tax and other payments. For additional discussion, please refer to the "Risk Factors" in Item 1A.

In the first quarter of fiscal year 2016, we used \$24.3 million for investing activities compared to \$25.6 million used in the first quarter of fiscal year 2015. In the first quarter of fiscal year 2016, we used \$27.3 million for purchases of property, plant and equipment, paid \$2.7 million to our deferred compensation plan trust account and invested \$2.1 million for notes receivable. These uses were partially offset by \$8.6 million received from sales of available-for-sale securities. In the first quarter of fiscal year 2015, we used \$21.7 million for purchases of property, plant and equipment and invested \$3.0 million for notes receivable.

In the first quarter of fiscal year 2016, financing activities provided \$49.8 million of net cash compared to \$7.3 million used in the first quarter of fiscal year 2015. In the first quarter of fiscal year 2016, we had net borrowings of \$232.5 million under our credit facility agreements and received \$15.3 million of proceeds from employee stock option exercises and employee stock purchases. These proceeds were partially offset by \$192.1 million used for the repurchase of VMS common stock and \$4.5 million used to satisfy employee tax withholding requirements for employees who tendered shares of VMS common stock upon vesting of restricted common stock and restricted stock units. In the first quarter of fiscal year 2015, we used \$125.5 million for the repurchase of VMS common stock, partially offset by \$87.5 million of net borrowings under our credit facility agreements and \$34.8 million of proceeds received from employee stock option exercises and employee stock purchases.

We expect our capital expenditures, which typically represent construction and/or purchases of facilities, manufacturing equipment, office equipment and furniture and fixtures, as well as capitalized costs related to the implementation of software applications, will be approximately 3% of revenues in fiscal year 2016.

On August 27, 2013, VMS entered into an agreement (as amended to date) with certain lenders and Bank of America, N.A. ("BofA") as administrative agent (the "Credit Agreement").

The Credit Agreement provides for (i) a five-year term loan facility in an aggregate principal amount of up to \$500 million (the "2013 Term Loan Facility") and (ii) a five-year revolving credit facility in an aggregate principal amount of up to \$500 million (the "2013 Revolving Credit Facility" and, collectively with the 2013 Term Loan Facility, the "2013 Credit Facility"). The 2013 Revolving Credit Facility also includes a \$50 million sub-facility for the issuance of letters of credit and permits swing line loans of up to \$25 million. In November 2015, we amended the Credit Agreement to increase the aggregate commitments under the revolving credit facility from \$300 million to \$500 million, reduce commitment fees and interest rate margins applicable to borrowings and increase the maximum consolidated leverage ratio that we must maintain. We may prepay, reduce or terminate the commitments without penalty. The 2013 Credit Facility contains provisions that limit our ability to pay cash dividends. The Credit Agreement will expire in August 2018. The proceeds of the 2013 Credit Facility will be used for working capital, capital expenditures, Company share repurchases, permitted acquisitions and other corporate purposes.

In addition, our Japanese subsidiary ("VMS KK") has an unsecured uncommitted credit agreement with Sumitomo Mitsui Banking Corporation that enables VMS KK to borrow and have outstanding at any given time a maximum of 3 billion Japanese Yen (the "Sumitomo Credit Facility"). In February 2016, the Sumitomo Credit Facility was extended and will expire in February 2017.

The following table summarizes our short-term and long-term debt:

	January 1, 2016			October 2, 2015		
	Amount	Weighted-Average Interest Rate		Amount	Weighted-Average Interest Rate	
Short-term debt:						
Current maturities of 2013 Term Loan Facility	\$50.0	1.42	%	\$50.0	1.32	%
2013 Revolving Credit Facility	315.0	1.56	%	90.0	1.57	%
Sumitomo Credit Facility	18.2	0.63	%	18.4	0.63	%
Total short-term debt	\$383.2			\$158.4		
Long-term debt:						
2013 Term Loan Facility	\$325.0	1.42	%	\$337.5	1.32	%
2013 Revolving Credit Facility	20.0	3.75	%	—	—	%
Total long-term debt	\$345.0			\$337.5		

See Note 7, "Borrowings" of the Notes to the Condensed Consolidated Financial Statements for a further information regarding the 2013 Credit Facility and the Sumitomo Credit Facility.

The following table provides additional information regarding our short-term borrowings (excluding current maturities of long-term debt):

(Dollars in millions)	First Quarter of Fiscal Year 2016	
Amount outstanding (at end of period)	\$333.2	
Weighted average interest rate (at end of period)	1.51	%
Average amount outstanding (during period)	\$218.7	
Weighted average interest rate (during period)	1.46	%
Maximum month-end amount outstanding during period	\$333.2	

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

Total debt as a percentage of total capital increased to 30.9% at January 1, 2016 from 22.3% at October 2, 2015 primarily due to increased borrowings under our 2013 Credit Facility. The ratio of current assets to current liabilities decreased to 1.66 to 1 at January 1, 2016 from 1.83 to 1 at October 2, 2015.

#### Days Sales Outstanding

Trade accounts receivable days sales outstanding ("DSO") increased to 99 days at January 1, 2016 compared to 85 days at January 2, 2015, primarily due to a decrease in the percentage of revenues from Imaging Components, an increase in the percentage of revenues from VPT, and the timing of collections from Oncology Systems. Excluding VPT, DSO was 88 days at January 1, 2016 compared to 77 days at January 2, 2015. Our accounts receivable and DSO are impacted by a number of factors, primarily including: the timing of product shipments, product installation or customer acceptance, collections performance, payment terms, the mix of revenues from different regions, and the effects of continued economic instability. As of January 1, 2016, approximately 8% of our net accounts receivable balance was related to customer contracts with remaining terms of more than one year.





#### Share Repurchase Program

We repurchased a total of 2,425,151 shares of VMS common stock for an aggregate total of \$192.1 million during the first quarter of fiscal year 2016 under our repurchase programs. In November 2015, the VMS Board of Directors authorized the repurchase of an additional 8,000,000 shares of VMS common stock through December 31, 2016. As of January 1, 2016, 7,000,000 shares of VMS common stock remained available for repurchase under our current repurchase program.

Subsequent to January 1, 2016, we paid \$40.4 million and received 519,186 shares of VMS common stock as part of an accelerated share repurchase.

Stock repurchases may be made in the open market, in privately negotiated transactions (including accelerated share repurchase programs), or under Rule 10b5-1 share repurchase plans, and also may be made from time to time or in one or more larger blocks. All shares that were repurchased under our share repurchase programs have been retired.

See Note 12, "Stockholders' Equity and Noncontrolling Interests" of the Notes to the Condensed Consolidated Financial Statements for further information.

#### Contractual Obligations

Long-term income taxes payable includes the liability for uncertain tax positions (including interest and penalties) and may also include other long-term tax liabilities. As of January 1, 2016, our liability for uncertain tax positions was \$44.8 million, of which we do not anticipate making any payments in the next 12 months. We are unable to reliably estimate the timing of the future payments related to uncertain tax positions; we believe that existing cash and cash equivalents and cash to be generated from operations and current or future credit facilities will be sufficient to satisfy any payment obligations that may arise related to our liability for uncertain tax positions.

As of January 1, 2016, our remaining commitment under the loan related to the New York Proton Center ("NYPC") was \$70.7 million to be paid primarily through fiscal year 2018. As of January 1, 2016, our outstanding commitment under the loan to Maryland Proton Therapy Center ("MPTC") was \$22.8 million, to be paid in four installments of \$5.7 million each on June 30, 2016, September 30, 2016, December 30, 2016 and March 31, 2017. As of January 1, 2016, our outstanding commitment under the loan to California Proton Treatment Center, LLC ("CPTC") was \$3.5 million which is expected to be drawn down during fiscal year 2016. See Note 15, "VPT Loans" for additional information.

As further described in Note 9, "Commitments and Contingencies" of the Notes to the Condensed Consolidated Financial Statements, as of January 1, 2016, we accrued \$8.6 million for environmental remediation liabilities. The amount accrued represents estimates of anticipated future costs and the timing and amount of actual future environmental remediation costs may vary as the scope of our obligations become more clearly defined.

As further described in Note 6, "Related Party Transactions" of the Notes to the Condensed Consolidated Financial Statements, as of January 1, 2016, we had an estimated fixed cost commitment of \$18.0 million related to dpiX's amended agreement through December 31, 2016. The fixed cost commitment for future years will be determined and approved by the dpiX board of directors at the beginning of each calendar year.

Except for the change in the outstanding balance under our term loan facility and the other items discussed above, there has been no significant change to the other contractual obligations we reported in our 2015 Annual Report.

#### Contingencies

##### Environmental Remediation Liabilities

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

##### Other Matters

From time to time, we are a party to or otherwise involved in legal proceedings, claims and government inspections or investigations and other legal matters both inside and outside the United States, arising in the ordinary course of our business or otherwise. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. See Note 9, "Commitments and Contingencies" of the Notes to the Condensed Consolidated Financial Statements, which discussion is incorporated herein by reference.



#### Off-Balance Sheet Arrangements

In conjunction with the sale of our products in the ordinary course of business, we provide standard indemnification of business partners and customers for losses suffered or incurred for property damages, death and injury and for patent, copyright or any other intellectual property infringement claims by any third parties with respect to our products. The terms of these indemnification arrangements are generally perpetual. Except for losses related to property damages, the maximum potential amount of future payments we could be required to make under these arrangements is unlimited. As of January 1, 2016, we have not incurred any significant costs since the spin-offs to defend lawsuits or settle claims related to these indemnification arrangements. As a result, we believe the estimated fair value of these arrangements is minimal.

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

#### Recent Accounting Pronouncements or Updates Not Yet Effective

In January 2016, the Financial Accounting Standards Board ("FASB") issued an amendment to its accounting guidance related to recognition and measurement of financial assets and financial liabilities. The amendment addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The amendment will be effective for us beginning in the first quarter of fiscal year 2019. We are evaluating the impact of adopting this guidance to our consolidated financial statements.

In November 2015, the FASB issued an amendment to its accounting guidance related to balance sheet classification of deferred taxes. The amendment requires that deferred tax liabilities and assets be classified as noncurrent in the statement of financial position. The amendment affects presentation only and will be effective for us beginning in the first quarter of fiscal year 2018. Early adoption is permitted. We are evaluating the impact of adopting this guidance to our consolidated financial statements.

In September 2015, the FASB issued a new accounting standard that eliminates the requirement to restate prior period financial statements for measurement period adjustments following a business combination. The new guidance will be effective for us beginning in the first quarter of fiscal year 2017. The new guidance is not expected to have a material impact to our consolidated financial statements.

In July 2015, the FASB issued an amendment to its accounting guidance related to inventory measurement. The amendment requires inventory measured using first-in, first-out (FIFO) or average cost to be subsequently measured at the lower of cost and net realizable value, thereby simplifying the current guidance that requires an entity to measure inventory at the lower of cost or market. The amendment will be effective for us beginning in the first quarter of fiscal year 2018. The new guidance is not expected to have a material impact to our consolidated financial statements.

In April 2015, the FASB issued an amendment to its accounting guidance related to internal use software. The amendment clarifies that the software license element of a cloud computing arrangements should be accounted for consistent with the acquisition of other software licenses. The amendment will be effective for us beginning in the first quarter of fiscal year 2017. Early adoption is permitted. We are evaluating the impact of adopting this guidance to our consolidated financial statements.

In April 2015, the FASB issued an amendment to its accounting guidance related to retirement benefits. The amendment provides a practical expedient that permits an entity with a fiscal year-end that does not coincide with a month-end to measure defined benefit plan assets and obligations using the month-end that is closest to the entity's fiscal year-end. The amendment also provides a practical expedient that permits an entity that has a significant event in an interim period to remeasure defined benefit plan assets and obligations using the month-end that is closest to the date of the significant event. The amendment will be effective for us beginning in the first quarter of fiscal year 2017. The amendment is not expected to have a material impact to our consolidated financial statements.

In March 2015, the FASB issued an amendment to its accounting guidance related to presentation of debt issuance costs. The amendment requires that debt issuance costs related to a recognized debt liability be presented in the

balance sheet as a direct deduction from the carrying amount of that debt liability. The amendment will be effective for us beginning in the first quarter of fiscal year 2017. In August 2015, the FASB further clarified that entities are permitted to defer and present debt issuance costs related to line-of-credit arrangements as assets. These amendments are not expected to have a material impact to our consolidated financial statements.

In February 2015, the FASB issued an amendment to its accounting guidance related to consolidation. The amendment modifies the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The amendment will be effective for us beginning in the first quarter of fiscal year 2017. The new guidance is not expected to have a material impact to our consolidated financial statements.

In June 2014, the FASB issued an amendment to its accounting guidance related to stock-based compensation. The amendment requires that a performance target that could be achieved after the requisite service period be treated as a performance condition that affects vesting, rather than a condition that affects the grant-date fair value. The new guidance will be effective for us beginning in the first quarter of fiscal year 2017. The amendment is not expected to have a material impact to our consolidated financial statements.

In May 2014, the FASB issued an amendment to its accounting guidance related to revenue recognition. The amendment sets forth a single, comprehensive revenue recognition model for all contracts with customers to improve comparability. The amendment requires revenue recognition to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In June 2015, the FASB approved a one-year deferral of the amendment. The new guidance will be effective for us beginning in the first quarter of fiscal year 2019, with early adoption permitted, but not before the first quarter of fiscal year 2018. The amendment can be applied either retrospectively to each prior reporting period presented (i.e., full retrospective adoption) or with the cumulative effect of initially applying the update recognized at the date of the initial application (i.e., modified retrospective adoption) along with additional disclosures. We are evaluating the impact of adopting this guidance to our consolidated financial statements.

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

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

#### Credit Risk and Counterparty Risk

We are exposed to credit loss in the event of nonperformance by counterparties on the foreign currency forward contracts used in hedging activities. These counterparties are large international and regional financial institutions and to date, no such counterparty has failed to meet its financial obligation to us under such contracts.

We are also exposed to credit loss in the event of default by counterparties of our financing receivables and CPTC, the obligor under the loan facility in which we are participating to finance the construction and start-up operations of the Scripps Proton Therapy Center. In November 2015, ORIX, J.P. Morgan and the Company (collectively the “Lenders”) and CPTC entered into a forbearance agreement whereby the lenders will not enforce their rights to principal and interest payments until April 2017, subject to CPTC maintaining certain covenants and achieving certain targets, with additional extensions through September 2017 based on hitting additional targets largely around patient volume and cash flow. In connection with the forbearance agreement, the Lenders agreed to make available up to an additional \$9.7 million of loan proceeds (based on their pro-rata share of the existing loan) with terms similar to the Tranche A loan for additional working capital needs; our proportionate share of this commitment is \$4.4 million and is expected to be drawn down during fiscal year 2016. There were no other significant changes to the loan agreements. As of January 1, 2016, our outstanding commitment under the CPTC loans was \$3.5 million.

In addition, cash and cash equivalents held with financial institutions may exceed the Federal Deposit Insurance Corporation insurance limits or similar limits in foreign jurisdictions. We also may need to rely on our credit facilities as described below under “Interest Rate Risk.” Our access to our cash and cash equivalents or ability to borrow could be reduced if one or more financial institutions with which we have deposits or from which we borrow should fail or otherwise be adversely impacted by conditions in the financial or credit markets. Conditions such as those we experienced as a result of the last economic downturn and accompanying contraction in the credit markets heighten these risks. Concerns over continued economic instability could make it more difficult for us to collect outstanding receivables and could adversely impact our liquidity.

#### 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 foreign currency rate movements could have a material negative impact on our financial results. Our primary exposures related to foreign currency denominated sales and purchases

are in Europe, Asia, Australia and Canada.

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

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

The notional values of our sold and purchased foreign currency forward contracts outstanding as of January 1, 2016 were \$458.5 million and \$79.0 million, respectively. The notional amounts of foreign currency forward contracts are not a measure of our exposure. The fair value of forward contracts generally reflects the estimated amounts that we would receive or pay to terminate the contracts at the reporting date, thereby taking into account and approximating the current unrealized and realized gains or losses of the open contracts. A move in foreign currency exchange rates would change the fair value of the contracts, and the fair value of the underlying exposures hedged by the contracts would change in a similar offsetting manner.

#### Interest Rate Risk

Our market risk exposure to changes in interest rates depends primarily on our investment portfolio and borrowings. Our investment portfolio primarily consisted of cash and cash equivalents and available-for-sale investments as of January 1, 2016. The principal amount of cash and cash equivalents at January 1, 2016 totaled \$953.4 million with a weighted average interest rate of 0.18%. At January 1, 2016, our available-for-sale investments included loans of \$86.7 million (including accrued interest) to CPTC, which bear interest at the London Interbank Offer Rate ("LIBOR") plus 7.00% per annum with a minimum interest rate of 9.00% per annum. The CPTC loans are carried at fair value. The Credit Agreement (as amended to date), which includes the 2013 Revolving Credit Facility and the 2013 Term Loan Facility, allows us to borrow up to a maximum amount of \$500 million under the 2013 Term Loan Facility and \$500 million under the 2013 Revolving Credit Facility.

Borrowings under the 2013 Term Loan Facility accrue interest either (i) based on a Eurodollar Rate, as defined in the Credit Agreement (the "Eurodollar Rate"), plus a margin of 0.875% to 1.125% based on a leverage ratio involving funded indebtedness and EBITDA or (ii) based upon a base rate of (a) the federal funds rate plus 0.50%, (b) BofA's announced prime rate, or (c) the Eurodollar Rate plus 1.00%, whichever is highest, plus a margin of up to 0.125% based on the same leverage ratio, depending upon instructions from VMS.

Borrowings under the 2013 Revolving Credit Facility accrue interest either (i) based on the Eurodollar Rate plus a margin of 1.125% to 1.375% based on a leverage ratio involving funded indebtedness and EBITDA or (ii) based upon a base rate of (a) the federal funds rate plus 0.50%, (b) BofA's announced prime rate, or (c) the Eurodollar Rate plus 1.00%, whichever is highest, plus a margin of 0.125% to 0.375% based on the same leverage ratio, depending upon instructions from VMS. Borrowings under the 2013 Revolving Credit Facility have a maturity of approximately 30 days if based on the Eurodollar Rate and the same maturity as the 2013 Term Loan Facility if based on the base rate. We are affected by market risk exposure primarily through the effect of changes in interest rates on amounts payable under our term loan facility and revolving credit facility. As of January 1, 2016, borrowings under the 2013 Term Loan Facility totaled \$375.0 million with a weighted average interest rate of 1.42% and borrowings under the 2013 Revolving Credit Facility totaled \$335.0 million with a weighted average interest rate of 1.69%. If our total borrowings under the 2013 Credit Facility remained at the level as of January 1, 2016 for an entire year and interest rates increased or decreased by 1%, our annual interest expense would increase or decrease, respectively, by approximately \$7.1 million. See Note 7, "Borrowings" of the Condensed Consolidated Financial Statements for a discussion regarding the 2013 Credit Facility.

In addition, the Sumitomo Credit Facility allows VMS KK to borrow up to a maximum amount of 3 billion Japanese Yen. Borrowings under the Sumitomo Credit Facility accrue interest based on the basic loan rate announced by the Bank of Japan plus a margin of 0.5% per annum. As of January 1, 2016, the outstanding balance under the Sumitomo Credit Facility was 3 billion Japanese Yen or \$18.2 million, with a weighted average interest rate of 0.63%.



To date, we have not used derivative financial instruments to hedge the interest rate within our investment portfolio and borrowings, but may consider the use of derivative instruments in the future.

The fair value of our loans to CPTC was \$86.7 million at January 1, 2016, which was estimated based on the income approach by using the discounted cash flow model with key assumptions that include discount rates corresponding to the terms and risks associated with the loan to CPTC. In addition, we do not increase the fair value above its par value as ORIX, the loan agent, has the option to purchase these loans from us under the original terms and conditions at par value. The CPTC loans are classified as Level 3 in the fair value hierarchy.

The estimated fair value of our term loan payable in fiscal year 2018, at January 1, 2016, approximated its carrying value because the term loan is carried at a market observable interest rate that resets periodically.

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

Disclosure controls and procedures. Based on the evaluation of our disclosure controls and procedures (as defined in the Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) required by Exchange Act Rules 13a-15(b) or 15d-15(b), our principal executive officer and principal financial officer have concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that information we are required to disclose in reports that we file or submit (a) 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.

Changes in internal control over financial reporting. There were no changes in our internal control over financial (b) reporting that occurred during the first quarter of fiscal year 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II

### OTHER INFORMATION

#### Item 1. Legal Proceedings

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

#### Item 1A. Risk Factors

The following risk factors and other information included in this Quarterly Report on Form 10-Q and in our 2015 Annual Report should be carefully considered. Although the risk factors described below are the ones management deems significant, additional risks and uncertainties not presently known to us or that we presently deem less significant may also adversely affect our business operations. If any of the following risks or additional risks and uncertainties actually occur, our business, operating results, and financial condition could be adversely affected. **OUR SUCCESS DEPENDS ON THE SUCCESSFUL DEVELOPMENT, INTRODUCTION AND COMMERCIALIZATION OF NEW GENERATIONS OF PRODUCTS AND ENHANCEMENTS TO OR SIMPLIFICATIONS OF EXISTING PRODUCT LINES**

Rapid change and technological innovation characterize the markets in which we operate. Our Oncology Systems products often have long development and government approval cycles, so we must anticipate changes in the marketplace, in technology and in customer demands. Our success depends on the successful development, introduction and commercialization of new generations of products (including linear accelerators, accessories, treatment systems and software products) and enhancements to and/or simplification of existing product lines. Our Oncology Systems products, including products such as EDGE and TrueBeam, are technologically complex and must keep pace with, if not be superior to, the products of our competitors in order to remain competitive. We are also expanding our software product lines and investing in the development of cloud and software-as-a-service ("SaaS") solutions. Development and introduction of new software platforms and software delivery models, as well as different revenue models, can be highly complex and uncertain, both in our ability to develop and implement such platforms or models and in our customers' acceptance of such platforms or models.

Our Imaging Components business, which sells primarily to a small number of imaging system OEM customers who use our products in their medical diagnostic, security and industrial imaging systems, must also continually introduce new products at competitive costs while also improving existing products with higher quality, lower costs and increased feature sets. Because this business competes in very price sensitive markets with other market players who are much larger and who may have "in-house" supplier of competing components, our ability to anticipate our customers' demands, innovate and introduce new products at a competitive cost and improve quality, cost and features of our existing products is extremely critical to our success in this business. Our failure to do so can and has resulted in loss of customers and adverse impact to our financial performance. With a strong U.S. Dollar, our ability to meet our customers' pricing expectations is particularly challenged and can result in erosion of product margin and market share.

We are investing in the growth of our Particle Therapy business, and expect that we will need to invest more to develop and commercialize new products and technology for this business. Accordingly, our products may require significant planning, design, development and testing, as well as significant capital commitments, involvement of senior management and other investments on our part. In addition, because of the large footprint and high price of many proton therapy systems, including ours, there is increasing demand for development of a smaller, more compact proton therapy system. Other companies currently offer smaller, less expensive proton therapy systems, and our ability to compete with these companies may depend on our ability to timely develop new technologies to reduce the size and price of our system or provide additional features and functionality that our competitors do not.

We may need to spend more time and money than we expect to develop and introduce new products or enhancements and, even if we succeed, they may not be sufficiently profitable such that we are able to recover all or a meaningful part of our investment. Once introduced, new products may adversely impact orders and sales of our existing

products, or make them less desirable or even obsolete, which could adversely impact our revenues and operating results. In addition, certain costs, including installation and warranty costs, associated with new products may be proportionately greater than the costs associated with other products, and may therefore disproportionately adversely affect our gross and operating margins. If we are unable to lower these costs over time, our operating results could be adversely affected. Compliance with regulations, competitive alternatives, and shifting market preferences may also impact our success with new products or enhancements.

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

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

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

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

**MORE THAN 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 57% and 52% of revenues from continuing operations during the first quarter of fiscal years 2016 and 2015, respectively, and 54%, 57% and 56% of our total revenues during fiscal years 2015, 2014 and 2013, respectively. As a result, we must provide significant service and support globally. We intend to continue to expand our presence in international markets and expect to expend significant resources in doing so. For example, we have aligned our resources to support sales and marketing efforts in emerging markets. We cannot be sure, however, that we will be able to meet our sales, service and support objectives or obligations in these international markets, or recover our investments. Our future results could be harmed by a variety of factors, including:

- currency fluctuations, such as the strengthening of the U.S. Dollar since the end of our fiscal year 2014, which has adversely affected our financial results and caused some customers to delay purchasing decisions or move to in-sourcing supply or migrate to lower cost alternatives or ask for additional discounts;
- the lower sales prices and gross margins usually associated with sales of our products in the international region, in particular emerging markets;
- the longer payment cycles associated with many foreign customers;
- difficulties in interpreting or enforcing agreements and collecting receivables through many foreign country’s legal systems;
- changes in the political, regulatory, safety or economic conditions in a country or region;



the imposition by governments of additional taxes, tariffs, global economic sanctions programs (such as the Russia-Ukraine sanctions) or other restrictions on foreign trade;

- the longer periods from placement of orders to revenue recognition in the international region;
- any inability to obtain required export or import licenses or approvals;
- failure to comply with export laws and requirements, which may result in civil or criminal penalties and restrictions on our ability to export our products, particularly our industrial linear accelerator products;
- failure to obtain proper business licenses or other documentation, or to otherwise comply with local laws and requirements regarding marketing, sales, service or any other business we conduct in a foreign jurisdiction, which may result in civil or criminal penalties and restrictions on our ability to conduct business in that jurisdiction; and
- the possibility that it may be more difficult to protect our intellectual property in foreign countries.

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

As of January 1, 2016, approximately 98% of our cash and cash equivalents were held abroad. If these funds were repatriated to the United States, a portion of this amount could be subject to additional taxation and our overall tax rate and our results of operations could suffer.

Our effective tax rate is impacted by tax laws in both the United States and in the countries in which our international subsidiaries do business. Earnings from our international region are generally taxed at rates lower than U.S. rates. A change in the percentage of our total earnings from the international region, a change in the mix of particular tax jurisdictions within the international region, or a change in currency exchange rates, could cause our effective tax rate to increase or decrease. Also, we are not currently taxed in the United States on certain undistributed earnings of certain foreign subsidiaries. These earnings could become subject to incremental foreign withholding or U.S. federal and state taxes should they either be deemed to be or actually are remitted to the United States, in which case our financial results would be adversely affected. In addition, changes in the valuation of our deferred tax assets or liabilities, changes in tax laws or rates, changes in the interpretation of tax laws or other changes beyond our control could adversely affect our financial position and results of operations.

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

Because our business is global and payments are generally made in local currency, fluctuations in foreign currency exchange rates can impact our results by affecting product demand, or our revenues and expenses, and/or the profitability in U.S. Dollars of products and services that we provide in foreign markets. For example, since the fourth quarter of fiscal year 2014, the U.S. Dollar has strengthened significantly against the Euro and Japanese Yen, which adversely impacted our financial results in fiscal year 2015 and in the first quarter of fiscal year 2016.

While we use hedging strategies to help offset the effect of fluctuations in foreign currency exchange rates, the protection these strategies provide is affected by the timing of transactions, and the effectiveness of the hedges, the number of transactions that are hedged and forecast volatility. If our hedging strategies do not offset these fluctuations, our revenues, margins and other operating results may be adversely impacted. Furthermore, movement in foreign currency exchange rates could impact our financial results positively or negatively in one period and not another, making it more difficult to compare our financial results from period to period.

In addition, our hedging program is designed to hedge currency movements on a relatively short-term basis (typically up to the next twelve month period). Therefore, we are exposed to currency fluctuations over the longer term.

Long-term movements in foreign currency exchange rates can also affect the competitiveness of our products in the local currencies of our international customers. Even though our international sales are mostly in local currencies, our cost structure is weighted towards the U.S. Dollar. The volatility of the U.S. Dollar that we have experienced over the last several years, and in particular the strengthening of the U.S. Dollar since the fourth quarter of fiscal year 2014, has affected the competitiveness of our pricing against our foreign competitors, some of which may have cost structures based in other currencies, either helping or hindering our international order and revenue growth, thereby affecting our overall financial performance and results. In addition, the negative impact of foreign currency exchange rates has caused some customers in our Imaging Components business to delay purchasing decisions or move to in-sourcing supply or migrate to lower cost alternatives or ask for additional discounts. Even if the U.S. Dollar weakens, these

customers may continue using the alternative sources and demand for our products may not increase.

Changes in monetary or other policies here and abroad, including as a result of economic and or political instability, or in reaction thereto, would also likely affect foreign currency exchange rates. Furthermore, in the event that one or more European countries were to replace the Euro with another currency, our sales into these countries, or into Europe generally, would likely be adversely affected until such time as stable exchange rates are established.

#### OUR RESULTS HAVE BEEN AND MAY CONTINUE TO BE AFFECTED BY CONTINUING WORLDWIDE ECONOMIC INSTABILITY

The global economy has been impacted by a number of economic and political factors, including recently the Russia-Ukraine sanctions. In many markets, these conditions have shrunk capital equipment budgets, slowed decision-making, made financing for large equipment purchases more expensive and more time consuming to obtain, and made it difficult for our customers and our vendors to accurately forecast and plan future business activities. This, in turn, has caused our customers to be more cautious with, and sometimes freeze, delay or dramatically reduce, purchases and capital project expenditures. Some countries have adopted and may in the future adopt austerity or stimulus programs that could positively or negatively affect our results from period to period, making it difficult for investors to compare our financial results. An uncertain economic environment may also disrupt supply or affect our service business, as customers' constrained budgets may result in pricing pressure, extended warranty provisions and even cancellation of service contracts.

In addition, concerns over continued economic instability could make it more difficult for us to collect outstanding receivables. Historically, our business has felt the effects of market trends later than other sectors in the healthcare industry, such as diagnostic radiology, and we may experience the effects of any economic recovery later than others in the healthcare industry. A continued weak or deteriorating healthcare market would inevitably adversely affect our business, financial conditions and results of operations.

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

Our products and those of OEMs that incorporate our products are subject to extensive and rigorous government regulation in the United States. 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. Furthermore, public media reports on misadministrations of radiotherapy in patients and focus on the role of the FDA in regulating medical devices has led to increased scrutiny of medical device companies and an increased likelihood of enforcement actions. U.S. laws governing marketing a medical device. In the United States, as a manufacturer and seller of medical devices and devices emitting radiation or utilizing radioactive by-product material, we and some of our suppliers and distributors are subject to extensive regulation by federal governmental authorities, such as the FDA, the Nuclear Regulatory Commission ("NRC") and state and local regulatory agencies, such as the State of California, to ensure the devices are safe and effective and comply with laws governing products which emit, produce or control radiation. These regulations govern, among other things, the design, development, testing, manufacturing, packaging, labeling, distribution, import/export, sale and marketing and disposal of our products.

Unless an exception applies, the FDA requires that the manufacturer of a new medical device or a new indication for use of, or other significant change in, an existing currently marketed medical device obtain either 510(k) pre-market notification clearance or pre-market approval ("PMA") before it can market or sell those products in the United States. Modifications or enhancements to a product that could significantly affect its safety or effectiveness, or that would constitute a major change in the intended use of the device, technology, materials, labeling, packaging, or manufacturing process also require a new 510(k) clearance. Although manufacturers make the initial determination whether a change to a cleared device requires a new 510(k) clearance, we cannot assure you that the FDA will agree with our decisions not to seek additional approvals or clearances for particular modifications to our products or that we will be successful in obtaining new 510(k) clearances for modifications. Obtaining clearances or approvals is time-consuming, expensive and uncertain, and the PMA process is more complex than the 510(k) clearance process. We may not be able to obtain the necessary clearances or approvals or may be unduly delayed in doing so, which



could harm our business. Furthermore, even if we are granted regulatory clearances or approvals, they may include significant limitations on the indicated uses of the product, which may limit the market for the product. If we were unable to obtain required FDA clearance or approval for a product or unduly delayed in doing so, or the uses of that product were limited, our business could suffer. In the past, our devices have generally been subject to 510(k) clearance or exempt from 510(k) clearance. However, there are some in the regulatory field who believe that certain medical devices should be required

to use the PMA approval process. If we were required to use the PMA process for future products or product modifications, it could delay or prevent release of the proposed products or modifications, which could harm our business.

Further, as we enter new businesses or pursue new business opportunities, such as radiosurgery and opportunities that require clinical trials, we become subject to additional laws, rules and regulations, including FDA and foreign rules and regulations that are applicable to the clinical trial process and protection of study subjects. Becoming familiar with and implementing the infrastructure necessary to comply with these laws, rules and regulations is costly. In addition, failure to comply with these laws, rules and regulations could delay the introduction of new products and could adversely affect our business.

**Quality systems.** Our manufacturing operations for medical devices, and those of our third-party manufacturers, are required to comply with the FDA's QSR, as well as other federal and state regulations for medical devices and radiation emitting products. The FDA makes announced and unannounced periodic and on-going inspections of medical device manufacturers to determine compliance with QSR and in connection with these inspections issues reports, known as Form FDA 483 reports when the FDA believes the manufacturer has failed to comply with applicable regulations and/or procedures. If observations from the FDA issued on Form FDA 483 reports are not addressed and/or corrective action taken in a timely manner and to the FDA's satisfaction, the FDA may issue a Warning Letter and/or proceed directly to other forms of enforcement action. Similarly, if a Warning Letter were issued, prompt corrective action to come into compliance would be required. Failure to respond timely to Form FDA 483 observations, a Warning Letter or other notice of noncompliance and to promptly come into compliance could result in the FDA bringing enforcement action against us, which could include the total shutdown of our production facilities, denial of importation rights to the U.S. for products manufactured in overseas locations, adverse publicity and criminal and civil fines. The expense and costs of any corrective actions that we may take, which may include products recalls, correction and removal of products from customer sites and/or changes to our product manufacturing and quality systems, could adversely impact our financial results and may also divert management resources, attention and time. Additionally, if a Warning Letter were issued, customers could delay purchasing decisions or cancel orders, and we could face increased pressure from our competitors who could use the Warning Letter against us in competitive sales situations, either of which could adversely affect our reputation, business and stock price.

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

If we initiate a correction or removal of a device to reduce a risk to health posed by the device, we would be required to submit a publicly available Correction and Removal report to the FDA and in many cases, similar reports to other regulatory agencies. This report could be classified by the FDA as a device recall which could lead to increased scrutiny by the FDA, other international regulatory agencies and our customers regarding the quality and safety of our devices. Furthermore, the submission of these reports have been and could be used against us by competitors in competitive situations and cause customers to delay purchase decisions, cancel orders or adversely affect our reputation.

Our medical devices utilizing radioactive material are subject to the NRC clearance and approval requirements, and the manufacture and sale of these products are subject to extensive federal and state regulation that varies from state to state and among regions. Our manufacture, distribution, installation and service (and decommissioning and removal) of medical devices utilizing radioactive material or emitting radiation also requires us to obtain a number of licenses and certifications for these devices and materials. Service of these products must also be in accordance with a specific radioactive materials license. Obtaining licenses and certifications may be time consuming, expensive and uncertain.

In addition, we are subject to a variety of environmental laws regulating our manufacturing operations and the handling, storage, transport and disposal of hazardous materials, and which impose liability for the cleanup of any contamination from these materials. In particular, the handling and disposal of radioactive materials resulting from the

manufacture, use or disposal of our products may impose significant costs and requirements. Disposal sites for the lawful disposal of materials generated by the manufacture, use or decommissioning of our products may no longer accept these materials in the future, or may accept them on unfavorable terms.

The FDA and the FTC also regulate advertising and promotion of our products to ensure that the claims we make are consistent with our regulatory clearances, that there are adequate and reasonable scientific data to substantiate the claims and that our promotional labeling and advertising is neither false nor misleading in any respect. If the FDA or FTC determines that any of our advertising or promotional claims are misleading, not substantiated or not permissible, we may be subject to enforcement actions, including Warning Letters, and may be required to revise our promotional claims and make other corrections or restitutions.

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

- adverse publicity affecting both us and our customers;
- increased pressures from our competitors;
- investigations by governmental authorities or Warning Letters;
- fines, injunctions, and civil penalties;
- partial suspensions or total shutdown of production facilities, or the imposition of operating restrictions;
- increased difficulty in obtaining required FDA clearances or approvals;
- losses of clearances or approvals already granted;
- seizures or recalls of our products or those of our customers;
- delays in purchasing decisions by customers or cancellation of existing orders;
- the inability to sell our products;
- difficulty in obtaining product liability or operating insurance at a reasonable cost, or at all; and
- civil fines and criminal prosecutions.

Other applicable U.S. regulations. As a participant in the healthcare industry, we are also subject to extensive laws and regulations protecting the privacy and integrity of patient medical information that we receive, including the HIPAA, “fraud and abuse” laws and regulations, including physician self-referral prohibitions, and false claims laws. From time to time, these laws and regulations may be revised or interpreted in ways that could make it more difficult for our customers to conduct their businesses, such as recent proposed revisions to the laws prohibiting physician self-referrals, and such revisions could have an adverse effect on the demand for our products, and therefore our business and results of operations. We also must comply with numerous federal, state and local laws of more general applicability relating to such matters as safe working conditions, manufacturing practices and fire hazard control. The laws and regulations and their enforcement are constantly undergoing change, and we cannot predict what effect, if any, changes to these laws and regulations may have on our business. For example, national and state laws regulate privacy and may regulate our use of data. Furthermore, HIPAA was amended by the HITECH Act to provide that business associates who have access to patient health information provided by hospitals and healthcare providers are now directly subject to HIPAA, including the new enforcement scheme and inspection requirements. Moreover, there has been a trend in recent years toward more stringent regulation and enforcement of requirements applicable to medical device manufacturers who receive or have access to patient health information.

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

#### **DISRUPTION OF CRITICAL INFORMATION SYSTEMS OR MATERIAL BREACHES IN THE SECURITY OF OUR PRODUCTS MAY ADVERSELY AFFECT OUR BUSINESS AND CUSTOMER RELATIONS**

Information technology helps us operate efficiently, interface with and support our customers, maintain financial accuracy and efficiency, and produce our financial statements. There is an increasing threat of information security attacks that pose risk to companies, including Varian. Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. If we do not allocate and effectively manage the resources necessary to build and sustain the proper technology infrastructure, we could be subject to, among other things, transaction errors, processing inefficiencies, the loss of customers, business disruptions, or the loss of or damage to intellectual property through a security breach. Such security breaches could expose us to a risk of loss of information, litigation and possible liability to employees, customers and regulatory authorities. If our data management systems do not effectively collect, secure, store, process and report relevant data for the operation of our business, whether due to equipment malfunction or constraints, software deficiencies, or human error, our ability to effectively plan, forecast and execute our business plan and comply with applicable laws and regulations will be impaired, perhaps materially. Any such impairment could materially and adversely affect our



financial condition, results of operations, cash flows and the timeliness with which we report our operating results internally and externally.

Moreover, we manufacture and sell hardware products that rely upon software systems to operate properly and software that deliver treatment instructions and store confidential patient information, and both types of products often are connected to and reside within our customers' information technology infrastructures. While we have implemented security measures to protect both our hardware and software products from unauthorized access, these measures may not be effective in fully securing these products, particularly since techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target. Additionally, we are developing and offering cloud and SaaS software products which reside upon and are hosted by third party providers. A security breach, whether of our products, of our customers' network security and systems or of third party hosting services could disrupt treatments occurring on our products, disrupt access to our customers' stored information, such as the patient treatment delivery instructions, and could lead to the loss of, damage to or public disclosure of our customers' stored information, including patient health information. Such an event could have serious negative consequences, including possible patient injury, regulatory action, fines, penalties and damages, reduced demand for our solutions, an unwillingness of our customers to use our solutions, harm to our reputation and brand, and time-consuming and expensive litigation, any of which could have an adverse effect on our financial results. If we were to experience a significant security breach of our information systems or data, the costs associated with the investigation, remediation and potential notification of the breach to customers and counter-parties could be material, and we may not have sufficient insurance to compensate us for those costs. In addition, if a material claim is successfully brought against us relating to a self-insured liability, we could have to pay substantial damages, in addition to any costs related to our defense, which could have a material adverse effect on our financial position and results of operations.

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

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

Marketing a medical device internationally. In order for us to market our products internationally, we must obtain clearances or approvals for products and product modifications. These processes (including for example in the European Union ("EU"), the European Economic Area ("EEA"), Switzerland, China, Japan and Canada) can be time consuming, expensive and uncertain, which can delay our ability to market products in those countries. Delays in receipt of or failure to receive regulatory approvals, the inclusion of significant limitations on the indicated uses of a product, the loss of previously obtained approvals or failure to comply with existing or future regulatory requirements could restrict or prevent us from doing business in a country or subject us to a variety of enforcement actions and civil or criminal penalties, which would adversely affect our business.

Within the EEA, we must affix a CE mark, a European marking of conformity that indicates that a product meets the essential requirements of the Medical Device Directive. This conformity to the Medical Device Directive is done through self-declaration and is verified by an independent certification body, called a "Notified Body." Once the CE mark is affixed, the Notified Body will regularly audit us to ensure that we remain in compliance with the applicable European laws and Medical Device Directive. By affixing the CE mark marking to our product, we are certifying that our products comply with the laws and regulations required by the EEA countries, thereby allowing the free movement of our products within these countries and others that accept CE mark standards. If we cannot support our performance claims and demonstrate compliance with the applicable European laws and Medical Device Directive, we would lose our right to affix the CE mark to our products, which would prevent us from selling our products within the EU/EEA/Switzerland territory and in other countries that recognize the CE mark. In September 2012, the European Commission adopted a Proposal for a Regulation of the European Parliament and of the Council on medical devices and a Proposal for a Regulation of the European Parliament and of the Council on in vitro diagnostic medical devices which will, once adopted by the European Parliament and by the Council, replace the existing three medical

devices directives. Since negotiation by member states of the available drafts are still ongoing, no publication of the new directive is expected until late 2016 at the earliest. The new proposal imposes stricter requirements for the placing in the market of medical devices as well as on the Notified Bodies. We may be subject to risks associated with additional testing, modification, certification or amendment of our existing market authorizations, or we may be required to modify products already installed at our customers' facilities in order to comply with the official interpretations of these revised regulations.

In addition, we are required to timely file various reports with international regulatory authorities, including reports required by international adverse event reporting regulations, that require that we report to regulatory authorities if our devices may have caused or contributed to a death or serious injury or malfunctioned in a way that would likely cause or contribute to a death or

serious injury if the malfunction were to recur. If these reports are not timely filed, regulators may impose sanctions, including temporarily suspending our market authorizations or CE mark, and sales of our products may suffer, and we may be subject to product liability or regulatory enforcement actions, all of which could harm our business.

Further, as we enter new businesses or pursue new business opportunities internationally, such as opportunities that require clinical trials, we may become subject to additional laws, rules and regulations. Becoming familiar with and implementing the infrastructure necessary to comply with these laws, rules and regulations is costly. In addition, failure to comply with these laws, rules and regulations could delay the introduction of new products and could adversely affect our business.

Manufacturing and selling a device internationally. We are also subject to laws and regulations that apply to manufacturers of radiation emitting devices and products utilizing radioactive materials, as well as laws and regulations of general applicability relating to matters such as environmental protection, safe working conditions, manufacturing practices and other matters. These are often comparable to, if not more stringent than, the equivalent regulations in the United States. Sales overseas are also affected by regulation of matters such as product standards, packaging, labeling, environmental and product recycling requirements, import and export restrictions, tariffs, duties and taxes.

In some countries, we rely on our foreign distributors and agents to assist us in complying with foreign regulatory requirements, and we cannot be sure that they will always do so. If we or any of our suppliers, distributors, agents or customers fail to comply with applicable international regulatory requirements or are perceived to potentially have failed to comply, we may face:

- adverse publicity affecting both us and our customers;
- investigations by governmental authorities;
- fines, injunctions, civil penalties and criminal prosecutions;
- increased difficulty in obtaining required approvals in foreign countries;
- losses of clearances or approvals already granted;
- seizures or recalls of our products or those of our customers;
- delays in purchasing decisions by customers or cancellation of existing orders; and
- the inability to sell our products in or to import our products into such countries.

Other applicable international regulations. We are subject to laws and regulations in foreign countries covering data privacy and other protection of health and employee information. Particularly within the EU/EEA/Switzerland area, data protection legislation is comprehensive and complex and there has been a recent trend toward more stringent enforcement of requirements regarding protection and confidentiality of personal data. Data protection authorities from the different member states of the EU may interpret the legislation differently, which adds to this complexity, and data protection is a dynamic field where guidance is often revised. Fully understanding and implementing this legislation could be quite costly and timely, which could adversely affect our business. Additionally, in some instances, in order to fulfill the requirements of applicable U.S. laws, we may be faced with deciding whether to comply with EU/EEA/Switzerland data protection rules. Failure or partial failure to comply with data protection rules and regulations across the EU/EEA/Switzerland area could result in substantial monetary fines. New data protection legislation that entail substantial changes to the current legal framework, some stricter than before, some less strict, were enacted by the EU Commission in 2015.

We are also subject to international “fraud and abuse” laws and regulations, as well as false claims and misleading advertisement laws. From time to time, these laws and regulations may be revised or interpreted in ways that could make it more difficult for our customers to conduct their businesses, which could have an adverse effect on the demand for our products, and therefore our business and results of operations. The laws and regulations and their enforcement are constantly undergoing change, and we cannot predict what effect, if any, changes to these laws and regulations may have on our business.

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



On March 23, 2010, President Obama signed into law the Affordable Care Act. The Affordable Care Act could adversely impact the demand for our products and services, and therefore our financial position and results of operations, possibly materially.

Specifically, one of the components of the law is a 2.3% excise tax on sales of most medical devices, which include our Oncology Systems and VPT products, which took effect on January 1, 2013. This tax has had and may in the future continue to have a negative impact on our gross margin, but was suspended for 2016 and 2017.

In addition, discussions relating to the Affordable Care Act have included the possibility for bundled reimbursement payments and accountable care organizations (“ACOs”). ACOs and bundled payment programs were established by the Affordable Care Act to reward integrated, efficient care and allow providers to share in any savings they achieve through the coordination of care and meeting certain mandated quality standards. ACOs and the bundled payment programs have primarily focused on primary care. However, some customers appear to be developing new partnerships across clinical specialties to prepare for the possibility of operating in an ACO environment and bundled reimbursement payments. These and other elements of the Affordable Care Act, including comparative effectiveness research, an independent payment advisory board, payment system reforms (including shared savings pilots) and the reporting of certain payments by us to healthcare professionals and hospitals (the “Physician Payment Sunshine Act”), could meaningfully change the way healthcare is developed and delivered, and may materially impact numerous aspects of our business, including the demand and availability of our products, the reimbursement available for our products from governmental and third-party payors, and reduced medical procedure volumes. We believe that growth of the radiation oncology market, which includes both traditional radiation therapy as well as proton therapy, in the United States is being adversely impacted as customers’ decision-making processes are complicated by the uncertainties surrounding the implementation of the Affordable Care Act and reimbursement rates for radiotherapy and radiosurgery, and that this uncertainty will likely continue into the next fiscal year and result in a high degree of variability of gross orders and revenue from quarter-to-quarter.

Various healthcare reform proposals have also emerged at the state level, and we are unable to predict which, if any of these proposals will be enacted. We are also unable to predict what effect ongoing uncertainty surrounding federal and state health reform proposals will have on our customer’s purchasing decisions. However, an expansion in government’s role in the U.S. healthcare industry may adversely affect our business, possibly materially.

#### CHANGES TO RADIATION ONCOLOGY AND OTHER REIMBURSEMENTS AND CHANGES IN INSURANCE DEDUCTIBLES AND ADMINISTRATION MAY AFFECT DEMAND FOR OUR PRODUCTS

Sales of our healthcare products indirectly depend on whether adequate reimbursement is available to our customers from a variety of sources, such as government healthcare insurance programs, including the Medicare and Medicaid programs; private insurance plans; health maintenance organizations; and preferred provider organizations. In general, employers and third-party payors in the United States have become increasingly cost-conscious, with higher deductibles imposed or encouraged in many medical plans. The imposition of higher deductibles tends to restrain individuals from seeking the same level of medical treatments as they might seek if the costs they bear are lower, particularly in the medical diagnostic portion of our business. Third-party payors have also increased utilization controls related to the use of our products by healthcare providers.

Furthermore, there is no uniform policy on reimbursement among third-party payors, and we cannot be sure that third-party payors will reimburse our customers for procedures using our products that will enable us to achieve or maintain adequate sales and price levels for our products. Without adequate support from third-party payors, the market for our products may be limited.

Once Medicare has made a decision to provide reimbursement for a given treatment, these reimbursement rates are generally reviewed and adjusted by Medicare annually. Private third-party payors, although independent from Medicare, sometimes use portions of Medicare reimbursement policies and payment amounts in making their own reimbursement decisions. As a result, decisions by CMS to reimburse for a treatment, or changes to Medicare’s reimbursement policies or reductions in payment amounts with respect to a treatment sometimes extend to third-party payor reimbursement policies and amounts for that treatment. We have seen our customers’ decision-making process complicated by the uncertainty surrounding Medicare reimbursement rates for radiotherapy and radiosurgery in the United States. From time to time, CMS and third-party payors may review and modify the factors upon which they rely to determine appropriate levels of reimbursement for cancer treatments. For example, CMS and third-party payors have begun to focus on the comparative effectiveness of radiation therapy versus other methods of cancer treatment, including surgery, and could modify reimbursement rates based on the results of comparative effectiveness studies. In

addition, discussions relating to the Affordable Care Act have included the possibility for bundled reimbursement payments and ACOs. Any significant cuts in reimbursement rates or changes in reimbursement methodology or administration for radiotherapy, radiosurgery, proton therapy or brachytherapy, or concerns or proposals regarding further cuts or changes in methodology or administration, could further increase uncertainty, influence our customers' decisions, reduce demand for our products, cause customers to cancel orders and have a material adverse effect on our revenues and stock price.

Foreign governments also have their own healthcare reimbursement systems and we cannot be sure that adequate reimbursement will be made available with respect to our products under any foreign reimbursement system. WE ARE SUBJECT TO FEDERAL, STATE AND FOREIGN LAWS GOVERNING OUR BUSINESS PRACTICES WHICH, IF VIOLATED, COULD RESULT IN SUBSTANTIAL PENALTIES. ADDITIONALLY, CHALLENGES TO OR INVESTIGATION INTO OUR PRACTICES COULD CAUSE ADVERSE PUBLICITY AND BE COSTLY TO RESPOND TO AND THUS COULD HARM OUR BUSINESS

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

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

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

Anti-corruption laws and regulations. We are also subject to the U.S. Foreign Corrupt Practices Act and anti-corruption laws, and similar laws in foreign countries, such as the U.K. Bribery Act of 2010, which became effective on July 1, 2011, and the Law “On the Fundamentals of Health Protection in the Russian Federation,” which became effective in January 2012. In general, there is a worldwide trend to strengthen anticorruption laws and their enforcement, and the healthcare industry and medical equipment manufacturers have been particular targets of these investigation and enforcement efforts. Any violation of these laws by us or our agents or distributors could create a substantial liability for us, subject our officers and directors to personal liability and also cause a loss of reputation in the market. Transparency International’s 2014 Corruption Perceptions Index measured the degree to which public sector corruption is perceived to exist in 174 countries/territories around the world, and found that nearly seventy percent of the countries in the index, including many that we consider to be high growth areas for our products, such as China, India, Russia and Brazil, scored below 50, on a scale from 100 (very clean) to 0 (highly corrupt). We

currently operate in many countries where the public sector is perceived as being more or highly corrupt. Our strategic business plans include expanding our business in regions and countries that are rated as higher risk for corruption activity by Transparency International. Becoming familiar with and implementing the infrastructure necessary to comply with laws, rules and regulations applicable to new business activities and mitigating and protecting against corruption risks could be quite costly. In addition, failure by us or our agents or distributors to comply with these laws, rules and regulations could delay our expansion into high-growth markets and could adversely affect our business. This notwithstanding, we will inevitably do more business, directly and potentially indirectly, in countries where the public sector is perceived to be more or highly corrupt and will be engaging in business in more countries perceived to be more or highly corrupt. Increased business in higher risk

countries could subject us and our officers and directors to increased scrutiny and increased liability. In addition, we have conducted, and in the future expect to conduct internal investigations or face audits or investigations by one or more domestic or foreign government agencies, which could be costly and time-consuming, and could divert our management and key personnel from our business operations. For example, in June 2015, one of our foreign subsidiaries was charged by the Department for Investigation and Penal Action of Lisbon with alleged improper activities relating to three tenders of medical equipment in Portugal during the period of 2003 to 2009. We previously undertook an internal investigation of this matter and voluntarily disclosed the results of this investigation to the U.S. Department of Justice and the U.S. Securities and Exchange Commission. At this time, we are unable to predict the ultimate outcome of this matter but intend to defend it vigorously. An adverse outcome under any such proceeding, investigation or audit could subject us to fines, or criminal or other penalties, which could adversely affect our business and financial results.

**Competition laws.** Due to our competitive position in many jurisdictions, compliance with competition laws is of increased importance to us. Regulatory authorities under whose laws we operate may have enforcement powers that can subject us to sanctions, and can impose changes or conditions in the way we conduct our business. In addition, an increasing number of jurisdictions also provide private rights of action for competitors or consumers to seek damages asserting claims of anti-competitive conduct. Increased government scrutiny of our actions or enforcement of private rights of action could adversely affect our business or damage our reputation. In addition, we have conducted, and in the future expect to conduct, internal investigations or face audits or investigations by one or more domestic or foreign government agencies, which could be costly and time-consuming, and could divert our management and key personnel from our business operations. An adverse outcome under any such investigation or audit could subject us to fines or criminal or other penalties, which could adversely affect our business and financial results.

**PRODUCT DEFECTS OR MISUSE MAY RESULT IN MATERIAL PRODUCT LIABILITY OR PROFESSIONAL ERRORS AND OMISSIONS CLAIMS, LITIGATION, INVESTIGATION BY REGULATORY AUTHORITIES OR PRODUCT RECALLS THAT COULD HARM OUR 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 and other situations where people may come into contact with radiation (for example, when our security and inspection products are being used to scan cargo), the collection and storage of patient treatment data for medical analysis and treatment delivery, the planning of radiation treatment and diagnostic imaging of the human body, and the diagnoses of medical problems, the possibility for significant injury and/or death exists to the intended or unintended recipient of the delivery. Our medical products operate within our customers' facilities and network systems, and under quality assurance procedures established by the facility that ultimately result in the delivery of radiation to patients. Human and other errors or accidents may arise from the operation of our products in complex environments, particularly with products from other vendors, where interoperability or data sharing protocol may not be optimized even though the equipment or system operates according to specifications. As a result, we may face substantial liability to patients, our customers and others for damages resulting from the faulty, or allegedly faulty, design, manufacture, installation, servicing, support, testing or interoperability of our products with other products, or their misuse or failure. In addition, third party service providers could fail to adequately perform their obligations, which could subject us to further liability. We may also be subject to claims for property damages or economic loss related to or resulting from any errors or defects in our products, or the installation, servicing and support of our products. Any accident or mistreatment could subject us to legal costs, litigation, adverse publicity and damage to our reputation, whether or not our products or services were a factor. In connection with our products that collect and store patient treatment data, we may be liable for the loss or misuse of such private data, if those products fail or are otherwise defective.

Product liability actions are subject to significant uncertainty and may be expensive, time-consuming, and disruptive to our operations. For these and other reasons, we may choose to settle product liability claims against us, regardless of their actual merit. If a product liability action were finally determined against us, it could result in significant damages, including the possibility of punitive damages and our consolidated financial position, results of operations or

cash flows could be materially adversely affected. Adverse publicity regarding any accidents or mistreatments, even ones that do not involve our products, could cause patients to be less receptive to radiotherapy or radiosurgery treatments, to question the efficacy of radiation therapy and radiosurgery and to seek other methods of treatment. Adverse publicity could also result in additional regulation of radiation therapy, radiosurgery, medical devices or the healthcare industry in general, and adversely affect our ability to promote, manufacture and sell our products. Both adverse publicity and increased regulatory activities could negatively impact our business and results of operations. In addition, if a product we design or manufacture were defective (whether due to design, labeling or manufacturing defects, improper use of the product or other reasons) or found to be so by a competent regulatory authority, we may be required to

correct or recall the product and notify other regulatory authorities. The adverse publicity resulting from a correction or recall, however imposed, could damage our reputation and cause customers to review and potentially terminate their relationships with us. A product correction or recall could consume management time and have an adverse financial impact on our business, including incurring substantial costs, losing revenues and accruing losses under GAAP.

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

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

Rapidly evolving technology, intense competition and pricing pressure characterize the markets for radiation therapy equipment and software. New competitors may enter our markets, and we have encountered new competitors as we have entered new markets such as radiosurgery, VMAT and proton therapy. Some of these competitors may have greater financial, marketing and other resources than we have. To compete successfully, we must provide technically superior, proven products that deliver more precise, cost-effective, high quality clinical outcomes, in a complete package of products and services, and do so ahead of our competitors. As our Oncology Systems products are generally sold on a basis of total value to the customer, our business may suffer when purchase decisions are based solely upon price, which can happen if hospitals and clinics give purchasing decision authority to group purchasing organizations. The shift in the proportion of sales within our international region towards emerging market countries, which typically have purchased less complex, lower-priced products compared to more developed countries, and which usually have stiffer price competition, could also adversely impact our results of operations. New competitors may also delay customer purchasing decisions as customers evaluate the products of these competitors along with ours, potentially extending our sales cycle and adversely affecting our gross orders.

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

With our security and inspection products, we compete with other OEM suppliers, primarily outside of the United States. The market for our X-ray tube and flat panel products used for nondestructive testing in industrial applications is small and highly fragmented.

The market for proton therapy products is still developing and is characterized by rapidly evolving technology and pricing pressure. Our ability to compete successfully depends, in part, on our ability to lower our product costs, develop and provide technically superior, proven products that deliver more precise, cost-effective, high quality clinical outcomes, including integration of technologies such as our On-Board Imager (“OBI”) for IGRT and our motion management technologies.

In each of our business segments, existing competitors’ actions and new entrants may adversely affect our ability to compete. These competitors could develop technologies and products that are more effective than those we currently use or produce or that could render our products obsolete or noncompetitive. In addition, the timing of our competitors’ introduction of products into the market could affect the market acceptance and market share of our products. Some



competitors offer specialized products that provide, or may be perceived by customers to provide, a marketing advantage over our mainstream cancer treatment products. Also, some of our competitors may not be subject to the same standards, regulatory and/or other legal requirements that we are subject to, and therefore, they could have a competitive advantage in developing, manufacturing and marketing products and services. Any inability to develop, gain regulatory approval for and supply commercial quantities of competitive products to the market as quickly and effectively as our competitors could limit market acceptance of our products and reduce our sales. In addition, some of our smaller competitors could be acquired by larger companies that have greater financial strength, which could enable them to compete more aggressively. Our competitors could also acquire some of our suppliers or distributors, which could disrupt these supply or distribution arrangements and result in less predictable and

reduced revenues in our businesses. Any of these competitive factors could negatively affect our pricing, sales, revenues, market share and gross margins and our ability to maintain or increase our operating margins.

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

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

Obtaining and maintaining interoperability and compatibility can be costly and time-consuming. While we try to use standard published protocols for communication with widely-used oncology products manufactured by other companies, if we cannot do this, we may need to develop individual interfaces so that our products communicate correctly with the other company products. When other companies modify the design or functionality of their products, this may affect their compatibility with our products. In addition, when we improve our products, customers may be reluctant to adopt our new technology due to potential interoperability issues. For example, a clinic may be unwilling to implement one of our new technologies because its third-party software does not yet communicate correctly with our new product. Our ability to obtain compatibility with products of other companies may depend on our ability to obtain adequate information from them regarding their products. In many cases, these third parties are our competitors and may schedule their product changes and delay their release of relevant information to place us at a competitive disadvantage. When we modify our products to make them interoperable or compatible with third-party products, we may be required to obtain additional regulatory clearances. This process is costly and could delay our ability to release our products for commercial use. It is also possible that, despite our best efforts, we may not be able to make our products interoperable or compatible with widely used third-party products or may only be able to do so at a prohibitive expense, making our products less attractive or more costly to our customers.

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

We file applications as appropriate for patents covering new products and manufacturing processes. We cannot be sure, however, that our current patents, the claims allowed under our current patents, or patents for technologies licensed to us will be sufficiently broad to protect our technology position against competitors. Issued patents owned by, or licensed to, us may be challenged, invalidated or circumvented, or the rights granted under the patents may not provide us with competitive advantages. We also cannot be sure that patents will be issued from any of our pending or future patent applications. Asserting our patent rights against others in litigation or other legal proceedings is costly and diverts managerial resources. For example, during September and October 2015, we filed several complaints in the U.S. and foreign courts and the U.S. International Trade Commission against Elekta AB and its subsidiaries alleging infringement of various patents relating to certain aspects of cone beam imaging, cone-beam gantries, volumetric modulated arc therapy, and MR-Linac. An unfavorable outcome in this or in any other 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 and other confidential rights. These protections may prove inadequate, since agreements may still be breached and we may not have adequate remedies for a breach, and our trade secrets may otherwise become known to or be independently developed by others. In the event that our proprietary or confidential information is misappropriated, our business and financial results could be adversely impacted. We have trademarks, both registered and unregistered, that are maintained and enforced to provide customer recognition for our products in the marketplace, but unauthorized third parties may still use them. We also have agreements with third parties that license to us certain patented or

proprietary technologies. In some cases products with substantial revenues may depend on these license rights. If we were to lose the rights to license these technologies, or our costs to license these technologies were to materially increase, our business would suffer.

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

There is a substantial amount of litigation over patent and other intellectual property rights in the industries in which we compete. Our competitors, like companies in many high technology businesses, continually review other companies' activities for possible conflicts with their own intellectual property rights. In addition, non-practicing entities may review our activities for conflicts with their patent 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. 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. For example, in September 2015, Elekta Ltd. and William Beaumont Hospital served the Company with a complaint alleging infringement of three patents related to certain aspects of cone beam imaging in conjunction with radiotherapy. This lawsuit is in the initial stages, and we are not able to predict its ultimate outcome. During September and October 2015, we filed several complaints against Elekta in the United States and foreign courts and in the U.S. International Trade Commission alleging patent infringement. We may incur substantial costs and expend significant management resources defending against these claims or prosecuting our claims and our defense of these claims or our prosecution of claims against Elekta may ultimately not be successful. 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 may not prevail in a dispute. We do not maintain insurance for intellectual property infringement, so costs of defense, whether or not we are successful in defending an infringement claim, will be borne by us and could be significant. If we are unsuccessful in defending or appealing an infringement claim, we may be subject to significant damages and our consolidated financial position, results of operations or cash flows could be materially adversely affected. If actual liabilities significantly exceed our estimates regarding potential liabilities, our consolidated financial position, results of operations or cash flows could be materially adversely affected. We may also be subject to injunctions against development and sale of our products, the effect of which could be to materially reduce our revenues. Furthermore, a third party claiming infringement may not be willing to license its rights to us, and even if a third party rights holder is willing to do so, the amounts we might be required to pay under the associated royalty or license agreement could be significant. As such, we could decide to alter our business strategy or voluntarily cease the allegedly infringing actions rather than face litigation or pay a royalty, which could adversely impact our business and results of operations.

#### **UNFAVORABLE RESULTS OF LEGAL PROCEEDINGS COULD MATERIALLY ADVERSELY AFFECT OUR FINANCIAL RESULTS**

From time to time, we are a party to or otherwise involved in legal proceedings, claims and government inspections or investigations and other legal matters, both inside and outside the United States, arising in the ordinary course of our business or otherwise. We are currently involved in various legal proceedings and claims, including product liability claims and intellectual property claims (such as the current litigation with Elekta Ltd. and William Beaumont Hospital), that have not yet been fully resolved and additional claims may arise in the future. Legal proceedings are often lengthy, taking place over a period of years with interim motions or judgments subject to multiple levels of review (such as appeals or rehearings) before the outcome is final. Litigation is subject to significant uncertainty and may be expensive, time-consuming, and disruptive to our operations. For these and other reasons, we may choose to settle legal proceedings and claims, regardless of their actual merit.

If a legal proceeding were finally resolved against us, it could result in significant compensatory damages, and in certain circumstances punitive or trebled damages, disgorgement of revenue or profits, remedial corporate measures or injunctive relief imposed on us. If our existing insurance does not cover the amount or types of damages awarded, or if other resolution or actions taken as a result of the legal proceeding were to restrain our ability to market one or more

of our material products or services, our consolidated financial position, results of operations or cash flows could be materially adversely affected. In addition, legal proceedings, and any adverse resolution thereof, can result in adverse publicity and damage to our reputation, which could adversely impact our business.

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

We obtain some of the components included in our products from a limited group of suppliers or from a single source supplier, such as the radioactive sources for high dose afterloaders, klystrons for linear accelerators, transistor arrays and cesium iodide coatings for flat panel detectors, and specialized integrated circuits, X-ray tube targets, housings, glass frames and various other components; and radiofrequency components, magnets and gantry hardware for proton therapy systems. If we lose any of these suppliers, if their operations were substantially interrupted, or if any of them failed to meet performance or quality specifications, we may be required to obtain and qualify one or more replacement suppliers. Such an event 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 these products by the FDA or obtain other applicable regulatory approvals in other countries. Events like these could significantly increase costs for the affected product and likely cause material delays in delivery of that and other related products. Although we have insurance to protect against business interruption loss, this insurance coverage may not be adequate or continue to remain available on acceptable terms, if at all. Furthermore, some of our single-source suppliers provide components for some of our rapidly growing product lines. Manufacturing capacity limitations of any of our suppliers or other inability of these suppliers to meet increasing demand could adversely affect us, resulting in curtailed growth opportunities for our affected product lines. Shortage of, and greater demand for, components and subassemblies could also increase manufacturing costs if the supply/demand imbalance increases the price of the components and subassemblies. Disruptions or loss of any of our limited- or sole-sourced components or subassemblies or the capacity limitations of the suppliers for these components or subassemblies, including the ones referenced above, could adversely affect our business and financial results and could damage our customer relationships.

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

We rely upon the supplies of certain raw materials such as tungsten, lead, iridium and copper for Oncology Systems and security and inspection products; copper, lead, tungsten, rhenium, molybdenum zirconium, and various high grades of steel alloy for X-ray tubes, and high-grade steel, high-grade copper and iron for VPT. Worldwide demand, availability and pricing of these raw materials have been volatile, and we expect that availability and pricing will continue to fluctuate in the future. If supplies are restricted or become unavailable or if prices increase, this could constrain our manufacturing of affected products, reduce our profit margins or otherwise adversely affect our business.

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC has promulgated rules regarding disclosure of the presence in a company's products of certain metals, known as "conflict minerals," which are metals mined from the Democratic Republic of the Congo and adjoining countries, as well as procedures regarding a manufacturer's efforts to identify the sourcing of those minerals from this region. Complying with these rules requires investigative efforts, which has and will continue to cause us to incur associated costs, and could adversely affect the sourcing, supply, and pricing of materials used in our products, or result in process or manufacturing modifications, all of which could adversely affect our results of operations.

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

We have seen and may continue to see some consolidation among our customers in our Oncology Systems business, as hospitals and clinics combine through mergers and acquisitions, and as they join group purchasing organizations or affiliated enterprises. In addition, we have seen and may continue to see integration of equipment and information systems among hospitals as they consolidate their networks. As customers consolidate and/or integrate, the volume of product sales to these customers might decrease. Alternatively, order size may increase, as what were previously more than one customer combine orders as one entity, or as groups of organizations combine their purchases. As a result, as orders increase in size and require more customer approvals, the purchasing cycle for our Oncology Systems products could lengthen. Both increased order size and extended purchasing cycles could cause our gross orders to be more volatile and less predictable. In addition, some customers appear to be developing new partnerships across clinical

specialties to prepare for the possibility of operating in an ACO environment and the possibility of bundled reimbursement payments. Group purchasing organizations often focus on pricing as the determinant in making purchase decisions. A reduction in gross orders could affect the level of future revenues, which would adversely affect our operating results, financial condition, and the price of VMS common stock.

**WE SELL OUR IMAGING COMPONENTS TO A LIMITED NUMBER OF OEM CUSTOMERS, MANY OF WHICH ARE ALSO OUR COMPETITORS, AND A REDUCTION IN BUSINESS OR INABILITY TO PROPERLY FORECAST SALES BY ONE OR MORE OF THESE CUSTOMERS COULD REDUCE OUR SALES**

We sell our X-ray tube products to a limited number of OEM customers, many of which are also our competitors with in-house X-ray tube manufacturing operations. If these customers manufacture a greater percentage of their components in-house or otherwise lower external sourcing costs, such as we have begun to see as a result of the recent strengthening of the U.S. Dollar, we could experience reductions in purchasing volume by, or loss of, one or more of these customers. Such a reduction or loss has had and will likely continue to have a material adverse effect on our Imaging Components business. In addition, if any of our customers modify their business operations in ways that result in a reduction in or the discontinuation of purchases of our imaging components products, or divest business operations to third parties that reduce or discontinue purchasing our imaging components products, it could have a material adverse effect on our Imaging Components business. Moreover, economic uncertainties over the past few years, natural disasters and other matters beyond our control have made it difficult for our OEM customers to accurately forecast and plan future business activities. Such economic uncertainties and natural disasters, as well as other factors, have previously impacted our Imaging Components business, resulting in inventory reduction efforts and slowdowns in sales at some of these customers. Similar inventory adjustments and slowdowns in sales could occur in the future. Our agreements for imaging components may contain purchasing estimates that are based on our customers' historical purchasing patterns, and actual purchasing volumes under the agreements may vary significantly from these estimates.

**ORDERS FOR OUR SECURITY AND INSPECTION PRODUCTS TEND TO BE UNPREDICTABLE**

Our Imaging Components business designs, manufactures, sells and services Linatron X-ray accelerators, imaging processing software and image detection products for security and inspection, such as cargo screening at ports and borders and nondestructive examination for a variety of applications, as well as industrial applications. We generally sell security and inspection products to OEMs who incorporate our products into their inspection systems, which are then sold to customs and other government agencies, as well as to commercial organizations in the casting, power, aerospace, chemical, petro-chemical and automotive industries. We believe growth in our security and inspection products 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. Orders for our security and inspection products have been and may continue to be unpredictable as governmental agencies may place large orders with us or our OEM customers in a short time period, and then may not place any orders for a long time period thereafter. Because it is difficult to predict our OEM customer delivery, the actual timing of sales and revenue recognition varies significantly. The market for border protection systems has slowed significantly and end customers, particularly in oil-based economies and war zones in which we have a significant customer base, are delaying system deployments or tenders and considering moving to alternative sources, resulting in a decline in the demand for security and inspection products which is expected to continue.

In addition, demand for our security and inspection products is heavily influenced by U.S. and foreign governmental policies on national and homeland security, border protection and customs revenue activities, which depend upon government budgets and appropriations that are subject to economic conditions, as well as political changes. We have seen customers freeze or dramatically reduce purchases and capital project expenditures, delay projects, or act cautiously as governments around the world wrestle with spending priorities. As economic growth remains sluggish in various jurisdictions and appears to be deteriorating in others, and as concerns about levels of government employment and government debt continue, we expect that these effects will also continue. Furthermore, bid awards in this business may be subject to challenge by third parties, as we have previously encountered with a large government project. These factors make the timing of orders, sales and revenues in this business more unpredictable and could cause volatility in our revenues and earnings, and therefore the price of VMS common stock.

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

In order to achieve market acceptance for our radiation therapy products, we often need to educate physicians about the use of treatment procedures such as IMRT, IGRT, VMAT, SRS, SBRT or proton therapy, overcome physician



objections to some of the effects of the product or its related treatment regimen, convince healthcare payors that the benefits of the product and its related treatment process outweigh its costs and help train qualified physicists in the skilled use of the product. For example, the complex and dynamic nature of IMRT and IGRT requires significant education of hospital personnel and physicians regarding the benefits of and practices associated with IMRT and IGRT. Further, the complexity and high cost of proton therapy requires similar significant education, as well as education regarding construction and facility requirements. We have devoted and will continue to devote significant resources on marketing and educational efforts to create awareness of IMRT, IGRT, VMAT stereotactic radiotherapy, SRS, SBRT and proton therapy generally, to encourage the acceptance and adoption of our

products for these technologies and to promote the safe and effective use of our products in compliance with their operating procedures. Future products may not gain adequate market acceptance among physicians, patients and healthcare payors, even if we spend significant time and expense educating them about these products.

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

Our future success depends, to a great degree, on our ability to retain, attract, expand, integrate and train our management team and other key personnel, such as qualified engineering, service, sales, marketing and other staff. We compete for key personnel with other medical equipment and software manufacturers and technology companies, as well as universities and research institutions. Because this competition is intense, compensation-related costs could increase significantly if the supply of qualified personnel decreases or demand increases. If we are unable to hire and train qualified personnel, we may not be able to maintain or expand our business. Additionally, if we are unable to retain key personnel, we may not be able to replace them readily or on terms that are reasonable, which also could hurt our business.

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

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

**WE MAY NOT REALIZE EXPECTED BENEFITS FROM ACQUISITIONS OF OR INVESTMENTS IN NEW BUSINESSES, PRODUCTS, OR TECHNOLOGIES, WHICH COULD HARM OUR BUSINESS**

We need to grow our businesses in response to changing technologies, customer demands and competitive pressures. In some circumstances, we may decide to grow our business through the acquisition of complementary businesses, products or technologies rather than through internal development. For example, during fiscal year 2014, we acquired certain assets of Velocity and Transpire, and during fiscal year 2015, we acquired Claymount and a majority interest in MeVis. Identifying suitable acquisition candidates can be difficult, time-consuming and costly, and we may not be able to identify suitable candidates or successfully complete identified acquisitions. In addition, completing an acquisition can divert our management and key personnel from our current business operations, which could harm our business and affect our financial results. Even if we complete an acquisition, we may not be able to successfully integrate newly acquired organizations, products, technologies or employees into our operations, or may not fully realize some of the expected synergies.

Integrating an acquisition can also be expensive and time-consuming, and may strain our resources. It may cost us more to commercialize new products than we originally anticipated, as we experienced with our proton therapy systems, or cause us to increase our expenses related to research and development, either of which could adversely impact our results of operations. In many instances, integrating a new business will also involve implementing or improving internal controls appropriate for a public company into a business that lacks them. It is also possible that an acquisition could increase our risk of litigation, as a third party may be more likely to assert a legal claim following an acquisition because of perceived deeper pockets or perceived greater value of a claim. In addition, we may be unable to retain the employees of acquired companies, or the acquired company's customers, suppliers, distributors or other partners for a variety of reasons, including the fact that these entities may be our competitors or may have close relationships with our competitors.

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

If we acquire a business, we allocate the total purchase price to the acquired businesses' tangible assets and liabilities, identifiable intangible assets and liabilities based on their fair values as of the date of the acquisition, and record the excess of the purchase price over those fair values as goodwill. If we fail to achieve the anticipated growth from an acquisition, or if we decide to sell assets or a business, we may be required to recognize an impairment loss on the write down of our assets and goodwill, which could adversely affect our financial results. In addition, acquisitions can result in potentially dilutive issuances

of equity securities or the incurrence of debt, contingent liabilities or expenses, or other charges, any of which could harm our business and affect our financial results.

Additionally, we have investments in privately held companies that are subject to risk of loss of investment capital. These investments are inherently risky, in some instances because the markets for the technologies or products these companies have under development may never materialize. If these companies do not succeed, we could lose some or all of our investment in these companies. For example, in fiscal year 2014, we recorded a charge relating to the impairment of a portion of a privately-held equity investment when we became aware of certain indicators of impairment.

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

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

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

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

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

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

Once orders are received and booked into backlog, factors that may affect whether these orders become revenue (or are cancelled or deemed dormant and reflected as a reduction in the net order amounts) and the timing of revenue include:

• delay in shipment due, for example, to an unanticipated construction delay at a customer location where our products are to be installed, cancellations or reschedulings by customers, extreme weather conditions, natural disasters, port

strikes or other labor actions;

• a challenge to a bid award for one or more of our products;

• delay in the installation and/or acceptance of a product;

• failure to satisfy contingencies associated with an order;

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the method of accounting used to recognize revenue;  
a change in a customer's financial condition or ability to obtain financing; or  
timing of necessary regulatory approvals or authorizations.  
Our quarterly operating results, including our margins, may also be affected by a number of other factors, including:  
changes in our or our competitors' pricing or discount levels;  
changes in foreign currency exchange rates;  
changes in the relative portion of our revenues represented by our various products, including the relative mix between higher margin and lower margin products;  
changes in the relative portion of our revenues represented by our international region as a whole, by regions within the overall region, as well as by individual countries (notably those in emerging markets);  
fluctuation in our effective tax rate, which may or may not be known to us in advance;  
changes to our organizational structure, which may result in restructuring or other charges;  
disruptions in the supply or changes in the costs of raw materials, labor, product components or transportation services;  
disruptions in our operations, including our ability to manufacture products, caused by events such as earthquakes, fires, floods, terrorist attacks or the outbreak of epidemic diseases;  
the impact of changing levels of sales on sole purchasers of certain of our imaging components;  
the unfavorable outcome of any litigation or administrative proceeding or inquiry, as well as ongoing costs associated with legal proceedings; and  
accounting changes and adoption of new accounting pronouncements.

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

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

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

The development of our VPT business enables us to offer products for delivering image-guided, intensity-modulated proton therapy for the treatment of cancer. Our success in this area will depend upon the wide-spread awareness, acceptance and adoption by the oncology market of proton therapy systems for the treatment of cancer. However, this technology has not been widely adopted and future developments may not be adopted as quickly as others.

Since proton therapy projects are generally large, highly customized and more complex than projects in our Oncology Systems radiotherapy business, planning for these projects takes more of our time and uses more of our resources. Many of the components used in proton therapy equipment require long lead times, which may require an increase in our inventory levels. This may cause fluctuations in the operating results of VPT that may make it difficult to predict our results and to compare our results from period to period. The construction of a proton therapy facility requires significant capital investment and may involve complex project financing. Consequently, this business is vulnerable to deterioration in general economic and market



conditions. The worldwide economic downturn resulted in a contraction in credit markets. This has made and may continue to make it more difficult for potential customers of this business to find appropriate financing for large proton therapy projects, which could cause them to delay or cancel their projects, or request that we participate in financing arrangements (such as we have for the Scripps Proton Therapy Center, Maryland Proton Therapy Center and The New York Proton Center) or make payment concessions in their agreements with us, which could impact our operating results. Challenges or delays in obtaining financing or commencing treatment could also impact the viability of one or more of our customers as a going concern. Changes in reimbursement rates for proton therapy treatments, or uncertainty regarding these reimbursement rates, such as we experienced in 2012 with the reductions to reimbursement rates for hospital based proton therapy centers in the United States by CMS, can affect growth or demand for our VPT products and services.

We compete for many proton therapy system sales through tenders, where parties compete on price and other factors. Many companies sell their products at a lower price than we do. If we are unable to lower our prices or our customers are not willing to pay for additional features and functionality that we may provide, there is a risk we will lose sales, and if we lower our prices to gain business, our margins and other financial results may suffer. Further, the award of certain proton therapy system orders may be subject to challenge by third parties, which can make these orders more unpredictable than orders for other products. Because an order for a proton therapy system can be relatively large and complex, the sales and customer decision cycles for proton therapy projects may take several years, and an order in one fiscal period (or the cancellation of an order as a result of bid challenge or otherwise) will cause our gross orders to vary significantly, making comparisons between fiscal periods more difficult. We expect that a limited number of customers will account for a substantial portion of VPT's business for the foreseeable future. In instances where one customer undertakes multiple proton center projects, an adverse event with respect to one project could cause an adverse event with respect to the other projects, which could adversely impact our operating results.

Our estimates as to future operating results include certain assumptions about the results of VPT's business. If we are incorrect in our assumptions, our financial results could be materially and adversely affected. It is possible that VPT could perform significantly below our expectations due to a number of factors that cannot be predicted with certainty, including future market conditions, revenue growth rates, and operating margins. These factors could adversely impact VPT's ability to meet its projected results, which could cause a portion or all of the goodwill of VPT to become impaired. As of January 1, 2016, the goodwill of VPT was \$48.3 million. If we determine that VPT's goodwill becomes impaired, we would be required to record a charge that could have a material adverse effect on our results of operations in such period.

#### **OUR VPT BUSINESS MAY SUBJECT US TO INCREASED RISK AND POTENTIAL LIABILITY**

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

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



BUSINESS, LIQUIDITY AND FINANCIAL POSITION

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We maintain a credit facility with debt outstanding that contains restrictive financial covenants, including financial covenants that require us to comply with specified financial ratios. We may have to curtail some of our operations to comply with these covenants. In addition, our revolving credit facility contains other affirmative and negative covenants that could restrict our operating and financing activities. These provisions limit our ability to, among other things, incur future indebtedness, contingent obligations or liens, guarantee indebtedness, make certain investments and capital expenditures, sell stock or assets and pay dividends, and consummate certain mergers or acquisitions. Because of the restrictions on our ability to create or assume liens, we may find it difficult to secure additional indebtedness if required. In addition, we have in the past used borrowings under our credit facility to fund the repurchase of VMS shares and we may continue to do so in the future. In the event that we cannot use borrowings under our credit facility to fund share repurchases, whether because we have drawn down the maximum amounts borrowable under our credit facility, to do so would violate covenants in our credit facility, or otherwise, and we do not have access to other cash resources necessary to fund the desired share repurchases, it could have an adverse effect on our earnings per share. Furthermore, if we fail to comply with the credit facility requirements, we may be in default. Upon an event of default, if the credit agreement is not amended or the event of default is not waived, the lender could declare all amounts outstanding, together with accrued interest, to be immediately due and payable. If this happens, we may not be able to make those payments or borrow sufficient funds from alternative sources to make those payments. Even if we were to obtain additional financing, that financing may be on unfavorable terms.

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

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

As our operations evolve over time, we may introduce new products or new technologies that require us to apply different accounting principles, including ones regarding revenue recognition, than we have applied in past periods. Currently, we recognize revenues for our proton therapy systems and proton therapy commissioning contracts and for certain highly customized image detection systems in our Imaging Components business under contract accounting rules, which affects the timing of revenue recognition. We could be required to apply contract accounting rules to other businesses in the future. Under contract accounting rules, the use of the percentage-of-completion method involves considerable use of estimates in determining revenues, costs and profits and in assigning dollar amounts to relevant accounting periods, estimates which must be periodically reviewed and appropriately adjusted. For example, revenues recognized under the percentage-of-completion method are based on contract costs incurred to date compared with total estimated contract costs. In circumstances in which the final outcome of a contract cannot be precisely estimated but a loss on the contract is not expected, we recognize revenues under the percentage-of-completion method based on a zero profit margin until more precise estimates can be made.

Recognizing revenues using the percentage-of-completion method based on a zero profit margin, as we had done with the revenues associated with the Scripps Proton Therapy Center in the earlier stages of the project lowers our gross margins and makes it more difficult to compare our financial results from quarter to quarter. In addition, if we were to recognize revenues for our proton therapy systems and services under either the completed contract method or outside of contract accounting rules altogether, we would defer revenue until a contract is completed or substantially completed. This may cause our results of operations to fluctuate from period to period.

If our estimates prove to be inaccurate or circumstances change over time, we would be required to adjust revenues or even record a contract loss in later periods, and our financial results could suffer. In addition, if a loss is expected on a contract under the percentage-of-completion method, the estimated loss would be charged to cost of sales in the period the loss is identified. The application of different types of accounting principles and related potential changes may make it more difficult to compare our financial results from quarter to quarter, and the trading price of VMS common

stock could suffer or become more volatile as a result.

AS A STRATEGY TO ASSIST OUR SALES EFFORTS, WE MAY PARTICIPATE IN PROJECT FINANCING OR OFFER EXTENDED PAYMENT TERMS, WHICH MAY ADVERSELY AFFECT OUR FINANCIAL RESULTS

We have provided financing for the construction and start-up operations of the Scripps Proton Therapy Center, Maryland Proton Therapy Center and the New York Proton Center, and we may provide or be requested to provide financing to other potential VPT customers in the future. Providing such financing could adversely affect our financial results, since we cannot

provide assurance that a center will be completed on time or within budget, that the center can or will generate sufficient patient volumes and revenues to support scheduled loan payments or to facilitate a refinancing, or that the borrower will have the financial means to pay off any financing at maturity. In addition, in connection with our financing of the Scripps Proton Therapy Center, we cannot provide any assurance that any additional portion of our loan can be syndicated to third parties, or that the loan facility can be successfully refinanced upon the maturity of the loan. In November 2015, we and the other lenders of the CPTC loan agreed to forebear principal and interest payments until April 2017. If a borrower does not have the financial means to pay off its debts, and if we cannot recover the amounts due us from the sale of any collateral, we may be required to write off all, or a portion of the loan, which would adversely affect our financial results.

In addition, in some circumstances we offer longer or extended payment terms for qualified customers in VPT or our other businesses. Many of the areas where we offer such longer or extended payment terms have under-developed legal systems for securing debt and enforcing collection of debt. As of January 1, 2016, customer contracts with remaining terms of more than one year amounted to approximately eight percent of our net accounts receivable balance. While we qualify customers to whom we offer longer or extended payment terms, their financial positions may change adversely over the longer time period given for payment. Concerns over continued economic instability could also make it more difficult for us to collect outstanding receivables. This may result in an increase in payment defaults and uncollectible accounts, or could cause us to increase our bad debt expense, which would adversely affect our net earnings. In addition, longer or extended payment terms could impact the timing of our revenue recognition, and they have in the past and may in the future result in an increase in our days sales outstanding.

#### **PROVISIONS OF DELAWARE LAW AND OUR CHARTER DOCUMENTS COULD BE INSUFFICIENT TO DETER A HOSTILE TAKEOVER; AND ACTIONS OF ACTIVIST STOCKHOLDERS COULD ADVERSELY AFFECT OUR BUSINESS**

Certain provisions of Delaware law and of our certificate of incorporation and by-laws could deter a hostile takeover, while others could be insufficient to deter a hostile takeover. Our stockholder rights plan expired in December 2008, and we did not renew it. In addition, in February 2014 our stockholders approved, and we filed an amendment to our certificate of incorporation to declassify our Board of Directors commencing in 2016. Both of these changes reduced our ability to defend against a hostile takeover. The remaining provisions of Delaware law and of our charter documents may not be effective in defending against a hostile takeover or attack by an activist stockholder that may not be in the best interest of all of our shareholders, which could distract our management and adversely affect our business. In addition, we may be subject to one or more campaigns by stockholders who desire to increase stockholder value in the short term. Any such campaign could be costly and time-consuming, disrupt our operations and divert the attention of management and our employees from executing on our strategic goals, any of which could have an adverse effect on our business.

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

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

Future changes in environmental laws could also increase our costs of doing business, perhaps significantly. Several countries, including some in the EU, now require medical equipment manufacturers to bear certain disposal costs of products at the end of the product's useful life, increasing our costs. The EU has also adopted directives that may lead to restrictions on the use of certain hazardous substances or other regulated substances in some of our products sold

there. These directives, along with another that requires material disclosure information to be provided upon request, could increase our operating costs. All of these costs, and any future violations or liabilities under environmental laws or regulations, could have a material adverse effect on our business.

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

We conduct a significant portion of our activities, including manufacturing, administration and data processing at facilities located in the State of California and other seismically active areas that have experienced major earthquakes and other natural disasters. We carry limited earthquake insurance that may not be adequate or continue to be available at commercially reasonable rates and terms. A major earthquake or other disaster (such as a major fire, hurricane, flood, tsunami, volcanic eruption or terrorist attack) affecting our facilities, or those of our suppliers, could significantly disrupt our operations, and delay or prevent product manufacture and shipment during the time required to repair, rebuild or replace our or our suppliers' damaged manufacturing facilities. These delays could be lengthy and costly. If any of our customers' facilities are adversely affected by a disaster, shipments of our products could be delayed. Additionally, customers may delay purchases of our products until operations return to normal. Even if we are able to quickly respond to a disaster, the ongoing effects of the disaster could create some uncertainty in the operations of our businesses, such as occurred following the March 2011 tsunami in Japan. In addition, our facilities may be subject to a shortage of available electrical power and other energy supplies. Any shortages may increase our costs for power and energy supplies or could result in blackouts, which could disrupt the operations of our affected facilities and harm our business. Further, our products are typically shipped from a limited number of ports, and any disaster, strike or other event blocking shipment from these ports could delay or prevent shipments and harm our business. In addition, concerns about terrorism, the effects of a terrorist attack, political turmoil or an outbreak of epidemic diseases, such as Ebola, could have a negative effect on our business operations, those of our suppliers and customers, and the ability to travel, resulting in adverse consequences on our revenues and financial performance. **WE WORK IN INTERNATIONAL LOCATIONS WHERE THERE ARE HIGH SECURITY RISKS, WHICH COULD RESULT IN HARM TO OUR EMPLOYEES OR CONTRACTORS OR CAUSE US TO INCUR SUBSTANTIAL COSTS**

We work in some international locations where there are high security risks, which could result in harm to our employees and contractors or substantial costs. Some of our services are performed in or adjacent to high-risk locations where the country or location and surrounding area is suffering from political, social, or economic issues; war or civil unrest, or has a high level of criminal or terrorist activity. In those locations where we have employees or operations, we may incur substantial costs to maintain the safety of our personnel. Despite these precautions, the safety of our personnel in these locations may continue to be at risk, and we may in the future suffer the loss of employees and contractors, which could harm our business and operating results.

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

(a) Not applicable

(b) Not applicable

(c) The following table provides information with respect to the shares of common stock repurchased by us during the first quarter of fiscal year 2016.

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 <sup>(1)</sup>
October 3, 2015 - October 30, 2015	556,039	\$76.15	556,039	869,112
October 31, 2015 - November 27, 2015	869,112	\$79.87	869,112	8,000,000
November 28, 2015 - January 1, 2016	1,000,000	\$80.32	1,000,000	7,000,000
Total	2,425,151	\$79.20	2,425,151	7,000,000

In November 2015, the VMS Board of Directors authorized the repurchase of an additional 8,000,000 shares of VMS common stock through December 31, 2016. Share repurchases may be made in the open market, in privately negotiated transactions (including accelerated share repurchase programs), or under Rule 10b5-1 share repurchase plans, and also may be made from time to time or in one or more larger blocks. All shares that were repurchased under the Company's share repurchase programs have been retired.

The preceding table excludes 55,439 shares of VMS common stock that were withheld by VMS in satisfaction of tax withholding obligations upon the vesting of restricted stock units granted under the Company's employee stock plans.

## Item 3. Defaults Upon Senior Securities

None.

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 5. Other Information

None.

## Item 6. Exhibits

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

The exhibits listed in the accompanying index to exhibits are filed or incorporated by reference as part of this Form 10-Q.

SIGNATURES

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

VARIAN MEDICAL SYSTEMS, INC.  
(Registrant)

Dated: February 9, 2016

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



# INDEX TO EXHIBITS

Exhibit No.	Description
10.1†	Form of Registrant's Nonqualified Stock Option Agreement under the Registrant's Third Amended and Restated 2005 Omnibus Stock Plan (effective for nonqualified stock option awards granted to executive officers after November 8, 2015) (incorporated by reference to Exhibit No. 10.1 to the Registrant's Form 8-K Current Report filed as of November 12, 2015, File No. 1-7598).
10.2†	Form of Registrant's Restricted Stock Unit Agreement under the Registrant's Third Amended and Restated 2005 Omnibus Stock Plan (effective for restricted stock unit awards granted to executive officers after November 8, 2015) (incorporated by reference to Exhibit No. 10.2 to the Registrant's Form 8-K Current Report filed as of November 12, 2015, File No. 1-7598).
10.3†	Form of Registrant's Performance Unit Agreement under the Registrant's Third Amended and Restated 2005 Omnibus Stock Plan (effective for performance unit awards granted to executive officers after November 8, 2015) (incorporated by reference to Exhibit No. 10.3 to the Registrant's Form 8-K Current Report filed as of November 12, 2015, File No. 1-7598).
10.4*	Amendment No. 2, effective as of November 25, 2015, to the Credit Agreement, dated as of August 27, 2013, among the Registrant, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer and each of the lenders signatory thereto.
10.5	Third Amendment to Loan and Security Agreement and Other Loan Documents And Amendment to Fee Deed of Trust and Leasehold Deed of Trust among ORIX Capital Markets, LLC, ORIX Capital Markets, LLC, Varian Medical Systems International AG, and JP Morgan Chase Bank, N.A., dated as of November 6, 2015 (incorporated by reference to Exhibit No. 10.41 to the Registrant's Form 10-K filed as of November 25, 2015, File No. 1-7598).
15.1*	Letter Regarding Unaudited Interim Financial Information.
31.1*	Chief Executive Officer Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act.
31.2*	Chief Financial Officer Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act.
32.1*	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document

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

† Management contract or compensatory arrangement

\* Filed herewith