

ACCURAY INC
Form 10-Q
February 01, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2015

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: 001-33301

ACCURAY INCORPORATED

(Exact Name of Registrant as Specified in Its Charter)

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Delaware

(State or Other Jurisdiction of Incorporation or Organization)

20-8370041

(IRS Employer Identification Number)

1310 Chesapeake Terrace

Sunnyvale, California 94089

(Address of Principal Executive Offices Including Zip Code)

(408) 716-4600

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

As of January 25, 2016, there were 80,842,841 shares of the Registrant's Common Stock, par value \$0.001 per share, outstanding.

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Accuray Incorporated

Form 10-Q for the Quarter Ended December 31, 2015

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

(in thousands, except share amounts and par value)

(Unaudited)

	December 31, 2015	June 30, 2015 (1)
Assets		
Current assets:		
Cash and cash equivalents	\$ 88,451	\$ 79,551
Short-term investments	67,304	64,306
Restricted cash	2,596	3,734
Accounts receivable, net of allowance for doubtful accounts of \$837 and \$709 as of December 31, 2015 and June 30, 2015, respectively	66,044	77,727
Inventories	111,513	106,151
Prepaid expenses and other current assets	13,598	15,991
Deferred cost of revenue	8,834	6,869
Total current assets	358,340	354,329
Property and equipment, net	29,550	31,829
Goodwill	57,892	58,054
Intangible assets, net	11,587	15,564
Deferred cost of revenue	2,152	1,500
Other assets	13,804	8,695
Total assets	\$ 473,325	\$ 469,971
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	\$ 19,561	\$ 13,096
Accrued compensation	20,484	21,934
Other accrued liabilities	23,839	18,720
Short-term debt	96,551	
Customer advances	19,377	19,385
Deferred revenue	94,386	96,780
Total current liabilities	274,198	169,915
Long-term liabilities:		
Long-term other liabilities	10,829	10,934
Deferred revenue	17,257	10,489
Long-term debt	110,172	202,853
Total liabilities	412,456	394,191
Commitment and contingencies (Note 5)		
Stockholders Equity:		

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Preferred stock, \$0.001 par value; authorized: 5,000,000 shares; no shares issued and outstanding		
Common stock, \$0.001 par value; authorized: 200,000,000 shares as of December 31, 2015 and June 30, 2015 respectively; issued and outstanding: 80,835,472 and 79,477,838 shares at December 31, 2015 and June 30, 2015, respectively	81	79
Additional paid-in capital	476,387	471,430
Accumulated other comprehensive loss	(1,243)	(426)
Accumulated deficit	(414,356)	(395,303)
Total stockholders' equity	60,869	75,780
Total liabilities and stockholders' equity	\$ 473,325	\$ 469,971

(1) The condensed consolidated balance sheet at June 30, 2015 has been derived from audited consolidated financial statements.

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

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

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended December		Six Months Ended December	
	2015	2014	2015	2014
Net revenue:				
Products	\$ 55,759	\$ 47,650	\$ 95,754	\$ 80,665
Services	53,153	50,505	102,789	99,871
Total net revenue	108,912	98,155	198,543	180,536
Cost of revenue:				
Cost of products	32,717	27,171	55,734	47,836
Cost of services	33,624	32,495	66,340	66,410
Total cost of revenue	66,341	59,666	122,074	114,246
Gross profit	42,571	38,489	76,469	66,290
Operating expenses:				
Research and development	14,931	13,917	29,227	28,066
Selling and marketing	15,076	15,802	28,493	33,776
General and administrative	12,688	12,361	26,104	23,311
Total operating expenses	42,695	42,080	83,824	85,153
Loss from operations	(124)	(3,591)	(7,355)	(18,863)
Other expense, net	(5,070)	(5,528)	(10,161)	(10,989)
Loss before provision for income taxes	(5,194)	(9,119)	(17,516)	(29,852)
Provision for income taxes	833	873	1,537	1,790
Net loss	\$ (6,027)	\$ (9,992)	\$ (19,053)	\$ (31,642)
Net loss per share basic and diluted	\$ (0.08)	\$ (0.13)	\$ (0.24)	\$ (0.41)
Weighted average common shares used in computing loss per share				
Basic and diluted	80,346	77,924	80,053	77,607
Net loss	\$ (6,027)	\$ (9,992)	\$ (19,053)	\$ (31,642)
Foreign currency translation adjustment	(469)	(624)	(727)	(1,066)
Unrealized gain (loss) on investments, net of tax	(128)	2	(90)	(139)
Comprehensive loss	\$ (6,624)	\$ (10,614)	\$ (19,870)	\$ (32,847)

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

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

(in thousands)

(Unaudited)

	Six Months Ended December 31,	
	2015	2014
Cash Flows From Operating Activities		
Net loss	\$ (19,053)	\$ (31,642)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	9,061	9,960
Share-based compensation	5,879	7,127
Amortization of debt issuance costs	771	732
Amortization and accretion of discount and premium on investments	536	488
Accretion of interest on debt	3,870	3,540
Recovery of (provision for) bad debt, net	128	(51)
Provision for write-down of inventories	729	747
Loss on disposal of property and equipment	8	
Changes in assets and liabilities:		
Restricted cash	950	
Accounts receivable	10,959	6,619
Inventories	(5,669)	(18,628)
Prepaid expenses and other assets	(3,546)	2,750
Deferred cost of revenue	(2,678)	1,933
Accounts payable	6,715	1,313
Accrued liabilities	5,414	(3,050)
Customer advances	294	732
Deferred revenue	5,912	4,445
Net cash provided by (used in) operating activities	20,280	(12,985)
Cash Flows From Investing Activities		
Purchases of property and equipment, net	(4,125)	(4,170)
Purchases of investments	(33,130)	(56,011)
Sales and maturities of investments	29,505	81,420
Net cash (used in) provided by investing activities	(7,750)	21,239
Cash Flows From Financing Activities		
Proceeds from employee stock plans	2,055	3,034
Taxes paid related to net share settlement of equity awards	(2,841)	(394)
Net cash (used in) provided by financing activities	(786)	2,640
Effect of exchange rate changes on cash and cash equivalents	(2,844)	(5,967)
Net increase in cash and cash equivalents	8,900	4,927
Cash and cash equivalents at beginning of period	79,551	92,346
Cash and cash equivalents at end of period	\$ 88,451	\$ 97,273

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

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Accuray Incorporated

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Summary of Significant Accounting Policies

Description of Business

Accuray Incorporated (together with its subsidiaries, the Company or Accuray) is incorporated in Delaware and has its principal place of business in Sunnyvale, California. The Company designs, develops and sells advanced radiosurgery and radiation therapy systems for the treatment of tumors throughout the body. The Company has offices in the United States, Switzerland, China and Japan and conducts its business worldwide.

Basis of Presentation and Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company transactions and balances have been eliminated in consolidation.

The accompanying condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (GAAP), pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). Certain information and note disclosures have been condensed or omitted pursuant to such rules and regulations. The unaudited condensed consolidated financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary for a fair presentation of the periods presented. The results for the three and six months ended December 31, 2015 are not necessarily indicative of the results to be expected for the year ending June 30, 2016, for any other future interim period or future year.

These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and accompanying notes for the year ended June 30, 2015 included in the Company's Annual Report on Form 10-K filed with the SEC on August 28, 2015. The Company's significant accounting policies are described in Note 2 to those audited consolidated financial statements and there have been no material changes to such policies.

Recent Accounting Standard Update Not Yet Effective

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In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers: Topic 606* (ASU 2014-09), to supersede nearly all existing revenue recognition guidance under GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. On July 9, 2015, FASB approved a one-year deferral of the effective period for ASU 2014-09. The standard will be effective for the Company for the first quarter of fiscal 2019, but entities will be permitted to early adopt the standard as of the original effective date, which would be the first quarter of fiscal 2018 for the Company. The Company may adopt either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (ii) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined per ASU 2014-09. The Company has not yet selected a transition method, has not yet determined whether it will select early adoption and is currently evaluating the impact of pending adoption of ASU 2014-09 on its consolidated financial statements and related disclosures.

Use of Estimates

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

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Concentration of Credit and Other Risks

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

For the three months ended December 31, 2015 and 2014, there were no customers that represented 10% or more of total net revenue. For the six months ended December 31, 2015, there was one customer that represented 11% of total net revenue. For the six months ended December 31, 2014, there were no customers that represented 10% or more of total net revenue. No customer accounted for more than 10% of the Company's total accounts receivable as of December 31, 2015. One customer accounted for 18% of the Company's total accounts receivable as of June 30, 2015.

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

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

Revenue Recognition

The Company earns revenue from the sale of products and related services. The Company records its revenues net of any value added or sales tax. For arrangements with multiple elements, the Company allocates arrangement fees to products and services based upon Vendor Specific Objective Evidence (VSOE) of fair value of the respective elements, Third-Party Evidence (TPE), or Best Estimate of Selling Price (BESP), using the relative selling price method.

Product and Service Revenue

The majority of product revenue is generated from sales of CyberKnife and TomoTherapy systems. If the Company is responsible for installation, the Company recognizes revenue after installation and acceptance of the system. Otherwise, revenue is recognized upon delivery, assuming all other revenue recognition criteria are met.

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The Company offers its systems with post-contract customer support (PCS) contracts, installation services, training and professional services. PCS contracts provide planned and corrective maintenance services, software updates, bug fixes, as well as call-center support. Service revenue is generated primarily from PCS (warranty period services and post warranty services), installation services, training, parts and upgrades that are sold under service contracts and professional services. PCS revenue is deferred and recognized over the service period. Installation service revenue is recognized concurrent with system revenue. Training and professional service revenues that are not deemed essential to the functionality of the systems are recognized as such services are performed.

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

Net Loss Per Common Share

Basic and diluted net loss per share is computed by dividing net loss attributable to stockholders by the weighted average number of common shares outstanding during the period.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2015	2014	2015	2014
Numerator:				
Net loss used in computing net loss per share	\$ (6,027)	\$ (9,992)	\$ (19,053)	\$ (31,642)
Denominator:				
Weighted average shares used in computing basic and diluted loss per share	80,346	77,924	80,053	77,607

The potentially dilutive shares of the Company's common stock resulting from the assumed exercise of outstanding stock options, the vesting of Restricted Stock Units (RSU), Market Stock Units (MSU) and Performance Stock Units (PSU), and the purchase of shares under the Employee Stock Purchase Program (ESPP), as determined under the treasury stock method, are excluded from the computation of diluted net loss per share because their effect would have been anti-dilutive. Additionally, the 3.75% Convertible Senior Notes due August 1, 2016 (the 3.75% Convertible Notes), the 3.50% Convertible Senior Notes due February 1, 2018 (the 3.50% Convertible Notes) and the 3.50% Series A Convertible Notes (the 3.50% Series A Convertible Notes) due February 1, 2018 (together, the Convertible Notes) are included in the calculation of diluted net income per share only if their inclusion is dilutive. For the three months ended December 31, 2015 and 2014, respectively, the potentially dilutive shares under the Convertible Notes were excluded from the calculation of diluted net loss per share as their inclusion would have been anti-dilutive. The following table sets forth all potentially dilutive securities excluded from the computation in the table above because their effect would have been anti-dilutive (in thousands):

	As of December 31,	
	2015	2014
Stock options	2,409	2,861
RSUs, PSUs and MSUs	4,834	5,069
3.50% Convertible Notes	8,378	8,378
3.50% Series A Convertible Notes	2,781	3,886
	18,402	20,194

Outstanding Convertible Notes Diluted Share Impact

The 3.75% Convertible Notes and 3.50% Series A Convertible Notes have an optional physical (share), cash or combination settlement feature and contain certain conditional conversion features. Due to the optional cash settlement feature and management's intent to settle the principal amount thereof in cash, the conversion shares underlying the outstanding principal amount of the 3.75% Convertible Notes and the 3.50% Series A Convertible Notes, totaling approximately 10.6 million shares and 13.2 million shares, respectively, were not included in the potentially diluted share count table above. The Company's average stock price did not exceed the conversion price of the 3.75% Convertible Notes as of December 31, 2015 and 2014, respectively. The 2.8 and 3.9 million potentially dilutive shares of the 3.50% Series A Convertible Notes as of December 31, 2015 and 2014, respectively, included in the table above represent the premium over the principal amount due to the higher average share price above the conversion price. The number of premium shares included in the Company's diluted share count will vary with fluctuations in the Company's share price. Higher actual share prices result in a greater number of premium shares.

Segment Information

The Company has determined that it operates in only one segment, as it only reports profit and loss information on an aggregate basis to its chief operating decision maker. Revenue by geographic region is based on the shipping addresses of the Company's customers. The following summarizes revenue by geographic region (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2015	2014	2015	2014
Americas	\$ 51,000	\$ 45,717	\$ 96,290	\$ 84,195
Europe, Middle East, India and Africa	15,739	26,094	38,773	57,031
Asia-Pacific (excluding Japan and India)	35,784	14,470	52,766	19,352
Japan	6,389	11,874	10,714	19,958
Total	\$ 108,912	\$ 98,155	\$ 198,543	\$ 180,536

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Information regarding geographic areas in which the Company has long lived tangible assets is as follows (in thousands):

	December 31, 2015	June 30, 2015
Americas	\$ 25,797	\$ 28,182
Europe, Middle East, India and Africa	686	929
Asia-Pacific (excluding Japan and India)	1,030	455
Japan	2,037	2,263
Total	\$ 29,550	\$ 31,829

2. Balance Sheet Components**Financing receivables**

A financing receivable is a contractual right to receive money, on demand or on fixed or determinable dates, that is recognized as an asset in the Company's balance sheet. The Company's financing receivables, consisting of its accounts receivable with contractual maturities of more than one year, totaled \$8.1 million and \$1.6 million at December 31, 2015 and June 30, 2015, respectively, and are included in Other Assets in the consolidated balance sheets. There was no balance in the allowance for doubtful accounts related to such financing receivables as of December 31, 2015 and June 30, 2015, respectively, as revenue is recognized on a cash basis for these receivables.

Inventories

Inventories consisted of the following (in thousands):

	December 31, 2015	June 30, 2015
Raw materials	\$ 49,391	\$ 46,356
Work-in-process	18,352	15,445
Finished goods	43,770	44,350
Inventories	\$ 111,513	\$ 106,151

Property and equipment, net

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

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	December 31, 2015		June 30, 2015
Furniture and fixtures	\$ 4,662	\$	4,674
Computer and office equipment	12,440		11,808
Software	11,094		10,992
Leasehold improvements	20,952		19,428
Machinery and equipment	49,548		47,031
Construction in progress	5,355		8,273
	104,051		102,206
Less: Accumulated depreciation	(74,501)		(70,377)
Property and equipment, net	\$ 29,550	\$	31,829

Depreciation expense related to property and equipment for the three and six months ended December 31, 2015 was \$2.5 million and \$5.1 million, respectively. Depreciation expense related to property and equipment for the three and six months ended December 31, 2014 was \$3.0 million and \$6.0 million, respectively.

Table of Contents**3. Goodwill and Intangible Assets***Goodwill*

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

	Six Months Ended December 31, 2015	Year Ended June 30, 2015
Balance at the beginning of the period	\$ 58,054	\$ 58,091
Currency translation	(162)	(37)
Balance at the end of the period	\$ 57,892	\$ 58,054

In the second quarter of fiscal 2016, the Company performed its annual goodwill impairment test. Based on this analysis, the Company determined that there was no impairment to goodwill. The Company will continue to monitor its recorded goodwill for indicators of impairment.

Intangible Assets

The Company's unamortized intangible assets associated with completed acquisitions at December 31, 2015 and June 30, 2015 are as follows (in thousands):

	Useful Lives (in years)	December 31, 2015			June 30, 2015		
		Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
Developed technology	5-6	\$ 46,746	\$ (35,159)	\$ 11,587	\$ 46,700	\$ (31,136)	\$ 15,564

The Company did not identify any triggering events that would indicate potential impairment of its definite-lived intangible and long-lived assets as of December 31, 2015 and June 30, 2015.

Amortization expense related to intangible assets for the three and six months ended December 31, 2015 was \$2.0 million and \$4.0 million, respectively. Amortization expense related to intangible assets for the three and six months ended December 31, 2014 was \$2.0 million and \$4.0 million, respectively.

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The estimated future amortization expense of purchased intangible assets as of December 31, 2015 is as follows (in thousands):

Year Ending June 30,		Amount
2016 (remaining 6 months)	\$	3,976
2017		7,568
2018		43
	\$	11,587

4. Financial Instruments

The Company considers all highly liquid investments held at major banks, certificates of deposit and other securities with original maturities of three months or less to be cash equivalents.

The Company classifies all of its investments as available-for-sale at the time of purchase because it is management's intent that these investments are available for current operations and includes these investments on its balance sheet as short-term investments. Investments with original maturities longer than three months include commercial paper, U.S. agency securities, non-U.S. government securities and investment-grade corporate debt securities. Investments classified as available-for-sale are recorded at fair market value with the related unrealized gains and losses included in accumulated other comprehensive income (loss), a

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component of stockholders' equity. Realized gains and losses are recorded based on specific identification of each security's cost basis.

The Company defines fair value as the price that would be received to sell 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 on the measurement date. The fair value hierarchy contains three levels of inputs that may be used to measure fair value, as follows:

Level 1 Unadjusted quoted prices that are available in active markets for the identical assets or liabilities at the measurement date.

Level 2 Other observable inputs available at the measurement date, other than quoted prices included in Level 1, either directly or indirectly, including:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets in non-active markets;
- Inputs other than quoted prices that are observable for the asset or liability; and
- Inputs that are derived principally from or corroborated by other observable market data.

Level 3 Unobservable inputs that cannot be corroborated by observable market data and require the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participant assumptions.

The following tables summarize the amortized cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category for cash, cash equivalents and short-term investments (in thousands):

	December 31, 2015				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value Cash and Cash Equivalents	Short-term Investments
Cash	\$ 85,262	\$	\$	\$ 85,262	\$
Level 1					
Money market funds	1,190			1,190	
	1,190			1,190	

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Level 2								
Commercial paper		10,109				1,999	8,110	
U.S. agency securities		27,000		(103)			26,897	
U.S. treasury bills		3,991		(6)			3,985	
Corporate notes		28,371		(59)			28,312	
		69,471		(168)		1,999	67,304	
Total	\$	155,923	\$	\$	(168)	\$	88,451 \$	67,304

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	June 30, 2015				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value	
				Cash and Cash Equivalents	Short-term Investments
Cash	\$ 73,444	\$	\$	\$ 73,444	\$
Level 1					
Money market funds	6,107			6,107	
	6,107			6,107	
Level 2					
Commercial paper	11,989				11,989
U.S. Agency securities	21,999	6	(14)		21,991
Non-U.S. government securities	1,504		(3)		1,501
Corporate notes	28,891		(66)		28,825
	64,383	6	(83)		64,306
Total	\$ 143,934	\$ 6	\$ (83)	\$ 79,551	\$ 64,306

The Company's Level 2 investments in the table above are classified as Level 2 items because quoted prices in an active market are not readily accessible for those specific financial assets, or the Company may have relied on alternative pricing methods that do not rely exclusively on quoted prices to determine the fair value of the investments.

The Company had investments that were in an unrealized loss position as of December 31, 2015. The Company determined that (i) it does not have the intent to sell any of these investments and (ii) it is not likely that it will be required to sell any of these investments before recovery of the entire amortized cost basis. The Company reviews its investments quarterly to identify and evaluate investments that have an indication of possible impairment. As of December 31, 2015, the Company anticipates that it will recover the entire carrying value of such investments and has determined that no other-than-temporary impairments associated with credit losses were required to be recognized during the six months ended December 31, 2015.

Contractual maturities of available-for-sale securities at December 31, 2015 were as follows (in thousands):

	December 31, 2015	
	Amortized Cost	Fair Value
Due in 1 year or less	\$ 44,236	\$ 44,181
Due in 1-2 years	23,236	23,123
	\$ 67,472	\$ 67,304

The following table summarizes the carrying values and estimated fair values of our short-term and long-term debt (in thousands):

	December 31, 2015		June 30, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
3.75% Convertible Notes	\$ 96,551	\$ 101,423	\$ 93,739	\$ 102,645
3.50% Convertible Notes	44,654	60,666	44,654	65,230
3.50% Series A Convertible Notes	65,518	95,570	64,460	102,760

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Total	\$	206,723	\$	257,659	\$	202,853	\$	270,635
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The short-term and long-term debt is measured on a non-recurring basis using Level 2 inputs based upon observable inputs of the Company's underlying stock price and the time value of the conversion option, since an observable quoted price of the Convertible Notes is not readily available.

5. Commitments and Contingencies

The Company's contractual obligations were presented in the Annual Report on Form 10-K for the previous annual reporting period ended June 30, 2015. There have been no material changes outside of the ordinary course of business in those obligations during the three months ended December 31, 2015.

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Litigation

From time to time, the Company is involved in legal proceedings arising in the ordinary course of its business. The Company records a provision for a loss when it believes that it is both probable that a loss has been incurred and the amount can be reasonably estimated. Currently, management believes the Company does not have any probable and estimable losses related to any current legal proceedings and claims. Although occasional adverse decisions or settlements may occur, except as described in the matters below, management does not believe that an adverse determination with respect to any of these claims would individually or in the aggregate materially and adversely affect the Company's financial condition or operating results. For certain legal proceedings, management believes that there is a reasonable possibility that material losses may be incurred; however, the Company is unable to reasonably estimate a range of reasonably possible losses with respect to these matters. Litigation is inherently unpredictable and is subject to significant uncertainties, some of which are beyond the Company's control. Should any of these estimates and assumptions change or prove to have been incorrect, the Company could incur significant charges related to legal matters that could have a material impact on its results of operations, financial position and cash flows.

Rotary Systems

On April 28, 2011, a former supplier to TomoTherapy, Rotary Systems Incorporated (Rotary Systems), filed suit in Minnesota state court, Tenth Judicial District, Anoka County, against TomoTherapy alleging misappropriation of trade secrets, as well as several other counts alleging various theories of injury. Rotary Systems alleges TomoTherapy misappropriated Rotary Systems' trade secrets pertaining to a component previously purchased from Rotary Systems, which TomoTherapy now purchases from a different supplier. The suit alleges TomoTherapy improperly supplied the alleged trade secrets to its present supplier, Dynamic Sealing Technologies Inc. (also a named defendant in the suit). Rotary Systems has made an unspecified claim for damages of greater than \$50,000. TomoTherapy moved to dismiss the case and, on August 29, 2011, the court granted the motion to dismiss with respect to all counts other than the count alleging misappropriation of trade secrets. On May 21, 2012, the court gave Rotary Systems sixty days to identify the alleged trade secrets with specificity or face dismissal of its claim with prejudice. The court held a hearing on September 20, 2012 to review Rotary Systems' amended complaint. TomoTherapy filed a motion for summary judgment on the trade secret claim, the court ruled in favor of TomoTherapy on December 5, 2013, and Rotary Systems appealed. On December 22, 2014, the Minnesota Court of Appeals reversed the district court's dismissal of Rotary Systems' trade secrets claim and remanded it to the district court but affirmed the dismissal of Rotary Systems' other claims. In late October 2015, a final scheduling order was confirmed for the remanded claims and the parties are currently in the process of conducting discovery.

Cowealth Medical

On February 27, 2014, Cowealth Medical Holding Co., Ltd. (Cowealth), Accuray's former distributor in China, submitted a request for binding arbitration with the International Chamber of Commerce International Court of Arbitration (ICC) alleging, among other matters, that Accuray breached its distributor agreement with Cowealth by wrongfully terminating Cowealth as its distributor and misappropriated certain of Cowealth's confidential information. Cowealth was seeking damages of approximately \$170.0 million and injunctive relief. Accuray filed counterclaims for damages of approximately \$35.0 million. Accuray's answer and counterclaim were submitted to the ICC on May 12, 2014, and Cowealth served its reply on June 27, 2014. A hearing was held in Hong Kong between January 26, 2015 and February 6, 2015. The parties filed closing submissions and reply closing submissions in March 2015. On October 29, 2015, the ICC ruled that Accuray was liable for certain damages and awarded Cowealth approximately \$3.4 million. On November 27, 2015, Cowealth applied for a correction to the award to revise the amount of damages upwards to approximately \$5.5 million. On January 21, 2016, the arbitrator granted Cowealth's application for a correction on the grounds that the original award amount was a clerical error on the part of the arbitrator. Interest on the final award amount will accrue at a rate of 5% per annum starting 30 days after the date the corrected award was issued until payment. Accordingly, management recorded a charge of \$3.4

million for the first fiscal quarter ending September 30, 2015, and an additional \$2.1 million for the second fiscal quarter ending December 30, 2015. The parties filed cost submissions and reply cost submissions in December 2015. The ICC will subsequently issue a separate ruling as to legal costs and associated expenses; however, management does not believe the likelihood of an award of legal fees to Cowealth is probable or estimable as of December 31, 2015, so no additional amount has been recorded. Prior to the ruling of the ICC, no accrual was established in the Company's consolidated financial statements because management did not believe the likelihood of an award of damages to Cowealth was probable or estimable. In addition, the Company won several of its counterclaims including the right to be assigned the existing service contracts between Cowealth and Accuray customers, transfer to Accuray any regulatory clearances, licenses or permits obtained and held for the purposes of selling the CyberKnife System in China and deliver any consigned parts in their possession.

Software License Indemnity

Under the terms of the Company's software license agreements with its customers, the Company agrees that in the event the software sold infringes upon any patent, copyright, trademark, or any other proprietary right of a third-party, it will indemnify its

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customer licensees against any loss, expense, or liability from any damages that may be awarded against its customer. The Company includes this infringement indemnification in all of its software license agreements and selected managed services arrangements. In the event the customer cannot use the software or service due to infringement and the Company cannot obtain the right to use, replace or modify the license or service in a commercially feasible manner so that it no longer infringes, then the Company may terminate the license and provide the customer a refund of the fees paid by the customer for the infringing license or service. The Company has not recorded any liability associated with this indemnification, as it is not aware of any pending or threatened actions that represent probable losses as of December 31, 2015.

6. Share-Based Compensation

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2015	2014	2015	2014
Cost of revenue	\$ 433	\$ 560	\$ 822	\$ 955
Research and development	622	804	1,171	1,698
Selling and marketing	758	835	1,402	1,486
General and administrative	1,552	1,655	2,484	2,988
	\$ 3,365	\$ 3,854	\$ 5,879	\$ 7,127

7. Debt*3.75% Convertible Senior Notes due August 2016*

On August 1, 2011, the Company issued the 3.75% Convertible Notes to certain qualified institutional buyers, or QIBs. The 3.75% Convertible Notes were offered and sold to the QIBs pursuant to Rule 144A under the Securities Act of 1933, as amended (the Securities Act), or Rule 144A. The net proceeds from the \$100 million offering, after deducting the initial purchaser's discount and commission and the related offering costs, were approximately \$96.1 million. The offering costs and the initial purchaser's discount and commission (which are recorded in Other Assets) are both being amortized to interest expense using the effective interest method over five years. The 3.75% Convertible Notes bear interest at a rate of 3.75% per year, payable semi-annually in arrears in cash on February 1 and August 1 of each year, beginning on February 1, 2012. The 3.75% Convertible Notes will mature on August 1, 2016, unless earlier repurchased, redeemed or converted. A portion of these notes were redeemed in January 2016, as noted in Note 9 below.

The 3.75% Convertible Notes were issued under an Indenture between the Company and The Bank of New York Mellon Trust Company, N.A., as trustee. Holders of the 3.75% Convertible Notes may convert their 3.75% Convertible Notes at any time on or after May 1, 2016 until the close of business on the business day immediately preceding the maturity date. Prior to May 1, 2016, holders of the 3.75% Convertible Notes may convert their 3.75% Convertible Notes only under the following circumstances: (1) during any calendar quarter after the calendar quarter ending September 30, 2011, and only during such calendar quarter, if the closing sale price of the Company's common stock for each of 20 or more trading days in the 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the conversion price in effect on the last trading day of the immediately preceding calendar quarter; (2) during the five consecutive business

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days immediately after any five consecutive trading-day period (such five consecutive trading-day period, the Note Measurement Period) in which the trading price per \$1,000 principal amount of 3.75% Convertible Notes for each trading day of that Note Measurement Period was equal to or less than 98% of the product of the closing sale price of shares of the Company's common stock and the applicable conversion rate for such trading day; (3) if the Company calls any or all of the 3.75% Convertible Notes for redemption, at any time prior to the close of business on the business day immediately preceding the redemption date; or (4) upon the occurrence of specified corporate transactions as described in the Indenture. Upon conversion by holders of the 3.75% Convertible Notes, the Company will have the right to pay or deliver, as the case may be, cash, shares of common stock of the Company or a combination thereof, at the Company's election. At any time on or prior to the 33rd business day immediately preceding the maturity date, the Company may irrevocably elect to (a) deliver solely shares of common stock of the Company in respect of the Company's conversion obligation or (b) pay cash up to the aggregate principal amount of the 3.75% Convertible Notes to be converted and pay or deliver, as the case may be, cash, shares of common stock of the Company or a combination thereof in respect of the remainder, if any, of the Company's conversion obligation in excess of the aggregate principal amount of the 3.75% Convertible Notes being converted. The initial conversion rate is 105.5548 shares of the Company's common stock per \$1,000 principal amount of 3.75% Convertible Notes (which represents an initial conversion price of approximately \$9.47 per share of the Company's common stock). The conversion rate, and thus the conversion price, are subject to adjustment as further described below.

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Holders of the 3.75% Convertible Notes who convert their 3.75% Convertible Notes in connection with a make-whole fundamental change, as defined in the Indenture, may be entitled to a make-whole premium in the form of an increase in the conversion rate. Additionally, in the event of a fundamental change, as defined in the Indenture, holders of the 3.75% Convertible Notes may require the Company to purchase all or a portion of their 3.75% Convertible Notes at a fundamental change repurchase price equal to 100% of the principal amount of 3.75% Convertible Notes, plus accrued and unpaid interest, if any, to, but not including, the fundamental change repurchase date.

Prior to the maturity date, the Company may redeem for cash all or a portion of the 3.75% Convertible Notes if the closing sale price of its common stock exceeds 130% of the applicable conversion price (the initial conversion price is approximately \$9.47 per share of common stock) of such 3.75% Convertible Notes for at least 20 trading days during any consecutive 30 trading-day period (including the last trading day of such period).

In accordance with ASC 470-20, *Debt with Conversion and Other Options*, the Company separately accounts for the liability and equity conversion components of the 3.75% Convertible Notes. The principal amount of the liability component of the 3.75% Convertible Notes was \$75.9 million as of the date of issuance based on the present value of its cash flows using a discount rate of 10%, our approximate borrowing rate at the date of the issuance for a similar debt instrument without the conversion feature. The carrying value of the equity conversion component was \$24.1 million. A portion of the initial purchaser's discount and commission and the offering costs totaling \$0.9 million was allocated to the equity conversion component. The liability component is being accreted to the principal amount of the 3.75% Convertible Notes using the effective interest method over five years. A portion of these notes were repurchased in January 2016, please refer to Note 9 below.

3.50% Convertible Senior Notes due February 2018

In February 2013, the Company issued \$115.0 million aggregate principal amount of its 3.50% Convertible Notes to certain QIBs. The 3.50% Convertible Notes were offered and sold to the QIBs pursuant to Rule 144A. The net proceeds from the offering, after deducting the initial purchaser's discount and commission and the related offering costs, were approximately \$110.5 million. The offering costs and the initial purchaser's discount and commission (which are recorded in Other Assets) are both being amortized to interest expense using the effective interest method over five years. The 3.50% Convertible Notes bear interest at a rate of 3.50% per year, payable semi-annually in arrears in cash on February 1 and August 1 of each year, which began on August 1, 2013. The 3.50% Convertible Notes will mature on February 1, 2018, unless earlier repurchased, redeemed or converted.

In April 2014, through a series of transactions, the Company refinanced approximately \$70.3 million aggregate principal amount of the 3.50% Convertible Notes with approximately \$70.3 million aggregate principal amount of the Company's new 3.50% Series A Convertible Senior Notes due 2018 (the 3.50% Series A Convertible Notes).

The 3.50% Convertible Notes were issued under an Indenture between the Company and The Bank of New York Mellon Trust Company, N.A., as trustee. Holders of the 3.50% Convertible Notes may convert their 3.50% Convertible Notes at any time until the close of business on the business day immediately preceding the maturity date. The 3.50% Convertible Notes are convertible, as described below into common stock of the Company at an initial conversion rate equal to 187.6877 shares of common stock per \$1,000 principal amount of the 3.50% Convertible Notes, which is equivalent to a conversion price of approximately \$5.33 per share of common stock, subject to adjustment.

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Holders of the 3.50% Convertible Notes who convert their 3.50% Convertible Notes in connection with a make-whole fundamental change, as defined in the Indenture, may be entitled to a make-whole premium in the form of an increase in the conversion rate. Additionally, in the event of a fundamental change, as defined in the Indenture, holders of the 3.50% Convertible Notes may require the Company to purchase all or a portion of their 3.50% Convertible Notes at a fundamental change repurchase price equal to 100% of the principal amount of 3.50% Convertible Notes, plus accrued and unpaid interest, if any, to, but not including, the fundamental change repurchase date.

In accordance with guidance in ASC 470-20, *Debt with Conversion and Other Options* and ASC 815-15, *Embedded Derivatives*, the Company determined that the embedded conversion components of the 3.50% Convertible Note do not require bifurcation and separate accounting. The remaining \$44.7 million principal amount of the 3.50% Convertible Note has been recorded in Long-term Debt on the consolidated balance sheet as of December 31, 2015.

3.50% Series A Convertible Senior Notes due February 2018

On April 17, 2014, the Company entered into note exchange agreements with certain holders (the Participating Holders) of the 3.50% Convertible Notes to refinance approximately \$70.3 million aggregate principal amount of the 3.50% Convertible Notes

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with approximately \$70.3 million aggregate principal amount of the 3.50% Series A Convertible Notes. Pursuant to the note exchange agreements, the Company also paid the Participating Holders an aggregate of approximately \$0.4 million in cash in connection with such transactions. The principal amount of 3.50% Convertible Notes refinanced for each \$1,000 principal amount of the 3.50% Series A Convertible Notes was \$1,000 and the amount in cash paid per \$1,000 principal amount of such 3.50% Convertible Notes delivered was determined in individual negotiations between the Company and each Participating Holder. The Series A Convertible Notes have the same interest rate, maturity and other terms as the 3.50% Convertible Notes, except that the 3.50% Series A Convertible Notes are convertible into cash, shares of the Company's common stock or a combination of cash and shares of common stock, at the Company's option.

The 3.50% Series A Convertible Notes were issued under an Indenture between the Company and The Bank of New York Mellon Trust Company, N.A., as trustee. Holders of the 3.50% Series A Convertible Notes may convert their Securities at any time on or after November 1, 2017 until the close of business on the business day immediately preceding the maturity date. Prior to November 1, 2017, holders of the 3.50% Series A Convertible Notes may convert their Securities only under the following circumstances: (1) during any calendar quarter after the calendar quarter ending September 30, 2014, and only during such calendar quarter, if the closing sale price of the Company's common stock for each of 20 or more trading days in the 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the conversion price in effect on the last trading day of the immediately preceding calendar quarter; (2) during the five consecutive business days immediately after any five consecutive trading-day period (such five consecutive trading-day period, the Note Measurement Period) in which the trading price per \$1,000 principal amount of 3.50% Series A Convertible Notes for each trading day of that Securities Measurement Period was equal to or less than 98% of the product of the closing sale price of shares of the Company's common stock and the applicable conversion rate for such trading day; or (3) upon the occurrence of specified corporate transactions as described in the Indenture. Upon conversion by holders of the 3.50% Series A Convertible Notes, the Company will have the right to pay or deliver, as the case may be, cash, shares of common stock of the Company or a combination thereof, at the Company's election. At any time on or prior to the 17th business day immediately preceding the maturity date, the Company may irrevocably elect to (a) deliver solely shares of common stock of the Company in respect of the Company's conversion obligation or (b) pay cash up to the aggregate principal amount of the 3.50% Series A Convertible Notes to be converted and pay or deliver, as the case may be, cash, shares of common stock of the Company or a combination thereof in respect of the remainder, if any, of the Company's conversion obligation in excess of the aggregate principal amount of the 3.50% Series A Convertible Notes being converted. The initial conversion rate is 187.6877 shares of the Company's common stock per \$1,000 principal amount of 3.50% Series A Convertible Notes (which represents an initial conversion price of approximately \$5.33 per share of the Company's common stock). The conversion rate, and thus the conversion price, are subject to adjustment as further described below.

Holders of the 3.50% Series A Convertible Notes who convert their Notes in connection with a make-whole fundamental change, as defined in the Indenture, may be entitled to a make-whole premium in the form of an increase in the conversion rate. Additionally, in the event of a fundamental change, as defined in the Indenture, holders of the 3.50% Series A Convertible Notes may require the Company to purchase all or a portion of their 3.50% Convertible Notes at a fundamental change repurchase price equal to 100% of the principal amount of the 3.50% Series A Convertible Notes, plus accrued and unpaid interest, if any, to, but not including, the fundamental change repurchase date.

In accordance with Accounting Standards Codification, or ASC 470-20, *Debt with Conversion and Other Options*, the Company separately accounts for the liability and equity conversion components of the 3.50% Series A Convertible Notes. The principal amount of the liability component of the 3.50% Series A Convertible Notes was \$62.5 million as of the date of issuance based on the present value of its cash flows using a discount rate of 7%, our approximate borrowing rate at the date of the issuance for a similar debt instrument without the conversion feature. The carrying value of the equity conversion component was \$7.9 million. In addition, the portion of the cash amount paid to the Participating Holders totaling \$0.4 million was allocated to the debt discount with the remaining \$47,000 to the equity component. The liability component is being accreted to the principal amount of the 3.50% Series A Convertible Notes using the effective interest method through the maturity in February 2018.

The following table presents the carrying values of all Convertible Notes as of December 31, 2015 (in thousands):

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	3.75% Notes		3.50% Notes		3.50% Series A Notes		Total	
Carrying amount of the equity conversion component	\$	23,189	\$		\$	7,844	\$	31,033
Principal amount of the Convertible Notes	\$	100,000	\$	44,654	\$	70,346	\$	215,000
Unamortized debt discount		(3,449)				(4,828)		(8,277)
Net carrying amount	\$	96,551	\$	44,654	\$	65,518	\$	206,723

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A summary of interest expense on the Convertible Notes is as follows (in thousands):

	Three months ended December 31,		Six months ended December 31,	
	2015	2014	2015	2014
Interest expense related to contractual interest coupon	\$ 1,990	\$ 1,943	\$ 3,935	\$ 3,886
Interest expense related to amortization of debt discount	1,950	1,782	3,870	3,541
Interest expense related to amortization of debt issuance costs	368	369	771	732
	\$ 4,308	\$ 4,094	\$ 8,576	\$ 8,159

8. Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss consist of net loss, unrealized gains and losses on available-for-sale investments, changes in foreign currency exchange rate translation and net changes related to defined benefit pension plan. These components are excluded from earnings and reported as a component of stockholders' equity. The foreign currency translation adjustment results from those subsidiaries not using the United States dollar as their functional currency since the majority of their economic activities are primarily denominated in their applicable local currency. Accordingly, all assets and liabilities related to these operations are translated at the current exchange rates at the end of each period. The resulting cumulative translation adjustments are recorded directly to the accumulated other comprehensive loss account in stockholders' equity. Revenues and expenses are translated at average exchange rates in effect during the period.

The components of accumulated other comprehensive loss in the equity section of the balance sheets are as follows (in thousands):

	December 31, 2015	June 30, 2015
Net unrealized loss on short-term investments	\$ (168)	\$ (77)
Cumulative foreign currency translation gain	442	1,168
Defined benefit pension obligation	(1,517)	(1,517)
Accumulated other comprehensive loss	\$ (1,243)	\$ (426)

9. Subsequent Events

New Debt Financing

On January 11, 2016, the Company closed a \$70.0 million straight debt financing agreement with Cerberus Business Finance, LLC, an affiliate of Cerberus Capital Management, L.P (the Financing Agreement). The net proceeds of the loan are required to be used, in addition to \$30.0 million of cash funded by the Company, to retire \$100.0 million of convertible notes at the earlier of August 2016 or when otherwise redeemed. This financing consists of a \$70.0 million first lien senior secured term loan with a 700 basis point margin and 1 percent LIBOR floor. The loan

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will be amortized at an effective rate of 5% annually with final payment due in 5 years and is subject to certain maintenance-based covenants. The covenants in the Financing Agreement include:

- **Secured leverage** defines the maximum amount of secured leverage that can be on the Company's books at a given point in time calculated by the total secured debt divided by the last twelve months' adjusted EBITDA;
- **Total leverage** defines the maximum amount of total leverage that can be on the Company's books at a given point in time calculated by the total debt divided by the last twelve months' adjusted EBITDA;
- **Fixed Charge Coverage Ratio** designed to ensure that the Company's cash fixed charges are met with adequate free cash flow based on a minimum coverage ratio to be set and maintained;
- **Minimum EBITDA** defines the minimum amount of adjusted EBITDA the Company must maintain and generate;
- **Maximum CapEx** defines how much cash the Company can use annually to pursue capital projects, purchase PP&E and other related activities during the life of the loan; and
- **Affirmative and negative covenants** defining reporting requirements, subsidiary asset restrictions, dividend distribution and repayment requirements among other general requirements.

3.75% Convertible Senior Notes partial Repurchase

In January 2016, the Company repurchased approximately \$63.4 million in aggregate principal amount of its 3.75% Convertible Senior Notes due August 2016 for \$66.6 million in cash. As \$63.4 million of the 3.75% Convertible Senior Notes were settled in cash, a total of 6.7 million potentially dilutive shares are no longer potentially outstanding from an EPS perspective, these shares were already noted in Note 1 above as being excluded due to being anti-dilutive in the current fiscal quarter of 2016. Following such transactions, approximately \$44.7 million aggregate principal amount of the 3.50% Convertible Notes, approximately \$36.6 million aggregate principal amount of the 3.75% Convertible Notes and approximately \$70.3 million of the 3.50% Series A Convertible Notes remained outstanding. The Company expects to record a charge in the third quarter of fiscal 2016 of approximately \$1.0 million associated with the repurchase of the notes.

Cowealth Medical Litigation

In February of 2014, Cowealth submitted a request for binding arbitration with the ICC alleging, among other matters, that Accuray breached its distributor agreement with Cowealth by wrongfully terminating Cowealth as its distributor and misappropriated certain of Cowealth's confidential information. Cowealth was seeking damages of approximately \$170.0 million and injunctive relief. On October 29, 2015, the ICC ruled that Accuray was liable for certain damages and awarded Cowealth approximately \$3.4 million, while denying Cowealth's claim for injunctive relief.

On November 27, 2015, Cowealth applied for a correction to the award dated October 29, 2015, to revise the amount of damages upwards to approximately \$5.5 million from the previously issued award of \$3.4 million. On January 21, 2016, the arbitrator granted Cowealth's application for a correction on the grounds that the original award amount was a clerical error on the part of the arbitrator. As the legal matter arose before December 31, 2015, management recorded the additional charge of \$2.1 million into accrued liabilities and general and

administrative expenses. After the initial award assessment of \$3.4 million in October 2015, no additional accrual had been recorded in the Company's consolidated financial statements because management did not believe the likelihood of an additional award of damages to Cowealth was probable or estimable. Under the terms of the ICC Rules of Arbitration all awards are binding and cannot be appealed by either party. Further issues relating to costs remain to be finalized in the arbitration, none of which will affect the binding outcome under the interim and corrected award. The ICC will subsequently issue a separate ruling as to legal costs and associated expenses; however, management does not believe the likelihood of an award of legal fees to Cowealth is probable or estimable as of the date of the financials, so no additional amount has been recorded.

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

The following discussion and analysis of our financial condition as of December 31, 2015 and results of operations for the three and six months ended December 31, 2015 and 2014 should be read together with our condensed consolidated financial statements and related notes included elsewhere in this report. Statements made in this Form 10-Q report that are not statements of historical fact are forward-looking statements and are subject to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements in this report relate, but are not limited, to: our future results of operations and financial position, including the sufficiency of cash resources and expected cash flows to fund future operations, including the next 12 months; our backlog and expectations regarding age-outs, cancellations of contracts and foreign currency impacts, the effects of our process improvements on age-outs, backlog and revenue; expected uses of cash during fiscal 2016; the anticipated drivers of our future capital requirements; the success of the MLC for the CyberKnife Systems, its impact on our business; our expectations regarding the factors that will impact long-term success, sales, competitive positioning and long-term success for our CyberKnife and TomoTherapy Systems; our belief that TomoTherapy Systems offer clinicians and patients significant benefits over other radiation therapy systems in the market; the anticipated risks associated with our foreign operations and fluctuations in the U.S. dollar and foreign currencies as well as our ability to mitigate such risks; the sufficiency of our cash, cash flow equivalents and investments to meet our anticipated cash needs for working capital and capital expenditures and our business strategy, plans and objectives. Forward-looking statements generally can be identified by words such as anticipates, believes, estimates, expects, intends, plans, predicts, projects, may, will be, will continue, will likely result, and similar expressions. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from expectations, including those risks discussed in this quarterly report, in particular under the heading "Risk Factors" in Part II, Item 1A as well as the risks detailed in Part I, Item 1A of the Company's annual report on Form 10-K for fiscal year 2015, in Part II, Item 1A of the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2015 and other filings we make with the Securities and Exchange Commission. Forward-looking statements speak only as of the date the statements are made and are based on information available to the Company at the time those statements are made and/or management's good faith belief as of that time with respect to future events. The Company assumes no obligation to update forward-looking statements to reflect actual performance or results, changes in assumptions or changes in other factors affecting forward-looking information, except to the extent required by applicable securities laws. Accordingly, investors should not place undue reliance on any forward-looking statements.

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

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Overview

Products and Markets

We are a radiation oncology company that develops, manufactures, sells and supports precise, innovative treatment solutions which set the standard of care, with the aim of helping patients live longer, better lives. Our leading edge technologies, the CyberKnife® and TomoTherapy Systems®, are designed to deliver advanced radiation therapy including radiosurgery, stereotactic body radiation therapy, intensity modulated radiation therapy, image-guided radiation therapy and adaptive radiation therapy tailored to the specific needs of each patient. The CyberKnife and TomoTherapy Systems are complementary offerings serving separate patient populations treated by the same medical specialty, radiation oncology, with advanced capabilities that offer increased treatment flexibility to meet the needs of an expanding patient population.

The CyberKnife Systems are robotic systems designed to deliver radiosurgery treatments to cancer tumors anywhere in the body. The CyberKnife Systems are the only dedicated, full-body robotic radiosurgery systems on the market. Radiosurgery is an alternative to traditional surgery for tumors and is performed on an outpatient basis in one to five treatment sessions. It enables the treatment of patients who otherwise would not be treated with radiation, who may not be good candidates for surgery, or who desire non-surgical treatments. The use of radiosurgery with CyberKnife Systems to treat tumors throughout the body has grown significantly in recent years, but currently only a small portion of the patients who develop tumors treatable with CyberKnife Systems are treated with these systems. A determination of when it may or may not be appropriate to use a CyberKnife System for treatment is at the discretion of the treating physician and depends on the specific patient. However, the CyberKnife Systems are generally not used to treat (1) very large tumors, which are considerably wider than the radiation beam that can be delivered by CyberKnife Systems, (2) diffuse wide-spread disease, as is often the case for late stage cancers, because they are not localized (though CyberKnife Systems might be used to treat a focal area of the disease) and (3) systemic diseases, like leukemia and lymphoma, which are not localized to an organ, but rather involve cells throughout the body. The addition of the multi-leaf collimator, or InCise MLC, now makes it faster and more efficient to treat a wider range of tumor types with the CyberKnife M6, including larger tumors and those with multiple sites of disease.

Our CyberKnife M6 Series Systems have the option of: fixed collimator, iris collimator and/or InCise MLC. The InCise MLC is designed specifically for the M6 Series. With the addition of the InCise MLC, clinicians can deliver the same precise radiosurgery treatments they have come to expect with the CyberKnife System, faster and for a wider range of tumor types. The InCise MLC was commercially launched in the third fiscal quarter of 2015.

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

- Continued adoption of our CyberKnife M6 Series Systems;
- Production and shipment of MLC that meets the standards that we, and our customers, expect in our products;

- Change in medical practice leading to utilization of stereotactic body radiosurgery more regularly as an alternative to surgery or other treatments;
- Greater awareness among doctors and patients of the benefits of radiosurgery with the CyberKnife Systems;
- Continued evolution in clinical studies demonstrating the safety, efficacy and other benefits of using the CyberKnife Systems to treat tumors in various parts of the body;
- Continued advances in our technology that improve the quality of treatments and ease of use of the CyberKnife Systems;
- Receipt of regulatory approvals in various countries which is expected to improve access to radiosurgery with the CyberKnife Systems in such countries;
- Medical insurance reimbursement policies that cover CyberKnife System treatments; and
- Our ability to expand sales of CyberKnife Systems in countries throughout the world.

The TomoTherapy Systems are advanced, fully integrated and versatile radiation therapy systems for the treatment of a wide range of cancer types. The TomoTherapy Systems are the only radiation therapy systems designed for image-guided intensity-modulated radiation therapy (IG-IMRT). The TomoTherapy H Series Systems come in configurations of TomoHTM, TomoHDTM and

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TomoHDTM. Based on a CT scanner platform, the systems provide continuous delivery of radiation from 360 degrees around the patient, or delivery from clinician-specified beam angles. These unique features, combined with daily 3D image guidance, enable physicians to deliver highly accurate, individualized dose distributions which precisely conform to the shape of the patient's tumor while minimizing dose to normal, healthy tissue, resulting in fewer side effects for patients. The TomoTherapy Systems are capable of treating all standard radiation therapy indications including breast, prostate, lung and head and neck cancers, in addition to complex treatments such as total marrow irradiation. Radiation therapy has been widely available and used in developed countries for decades, though many developing countries do not currently have a sufficient number of radiation therapy systems to adequately treat their domestic cancer patient populations. The number of radiation therapy systems in use and sold each year is currently many times larger than the number of radiosurgery systems. We believe the TomoTherapy Systems offer clinicians and patients significant benefits over other radiation therapy systems in the market. We believe our ability to capture more sales will be influenced by a number of factors including the following:

- Continued adoption of our TomoTherapy H Series Systems;
- Greater awareness among doctors and patients of the benefits of radiation therapy using TomoTherapy Systems;
- Advances in our technology which improve the quality of treatments and ease of use of TomoTherapy Systems;
- Greater awareness among doctors of the now-established reliability of TomoTherapy Systems; and
- Our ability to expand sales of TomoTherapy Systems in countries throughout the world.

Sale of Our Products

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

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In the United States, we primarily market directly to customers, including hospitals and stand-alone treatment facilities, through our sales organization and we also market to customers through sales agents and group purchasing organizations. Outside the United States, we market to customers directly and through distributors and some sales agents. In addition to our offices in the United States, we have sales and service offices in many countries in Europe, Japan and other countries in Asia, South America, and throughout the world.

Backlog

For orders that cover both products and services, only the portion of the order that is recognizable as product revenue is reported as backlog. The portion of the order that is recognized as service revenue (for example, Post Contract Customer Support (PCS), installation, training and professional services) is not included in reported backlog. Product backlog totaled \$366.7 million as of December 31, 2015.

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

- The contract is signed and properly executed by both the customer and us. A customer purchase order that is signed and incorporates the terms of our contract quote will be considered equivalent to a signed and executed contract;
- The contract is non-contingent - it either has cleared all its contingencies or contains no contingencies when signed;
- We have received a minimum deposit or a letter of credit; the sale is a direct channel sale to a government entity, or the product has shipped to a customer with credit sufficient to cover the minimum deposit;
- The specific end customer site has been identified by the customer in the written contract or written amendment;
- For orders in our Latin America region, unless the system has already shipped and collection is reasonably assured, we request supporting evidence that the end customer has commenced construction to place our products if a site does not already exist; and

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- Less than 2.5 years have passed since the contract met all the criteria above.

Although our backlog includes only contractual agreements with our customers for the purchase of CyberKnife Systems, TomoTherapy Systems and related upgrades, due to factors outside of our control, we cannot provide assurance that we will convert backlog into recognized revenue. The amount of backlog recognized into revenue is primarily impacted by three items: cancellations, age-outs and foreign currency fluctuations. Orders could be cancelled for reasons including, without limitation, changes in customers' needs or financial condition, changes in government or health insurance reimbursement policies, changes to regulatory requirements, or other reasons. In addition to cancellations, after 2.5 years, if we have not been able to recognize revenue on a contract, we remove the revenue associated with the contract from backlog and the order is considered aged out. Contracts may age-out for many reasons, including inability of the customer to pay, inability of the customer to adapt their facilities to accommodate our products in a timely manner, inability to timely obtain licenses necessary for customer facilities or operation of our equipment among other reasons for delays. Our backlog also includes amounts not denominated in U.S. Dollars and therefore fluctuations in the U.S. Dollar as compared to other currencies will impact backlog. Generally, strengthening in the U.S. Dollar will negatively impact backlog.

Gross orders are defined as the sum of new orders recorded during the period adjusted for any revisions to existing orders during the period. Net product orders are defined as gross product orders less cancellations, age-outs and foreign exchange adjustments.

(Dollars in thousands)	Three months ended December 31,		Six months ended December 31,	
	2015	2014	2015	2014
Gross orders	\$ 67,078	\$ 72,261	\$ 132,006	\$ 131,024
Net orders	42,679	41,474	87,478	73,756
Order backlog at the end of the period	366,668	357,831	366,668	357,831

Gross orders decreased by \$5.2 million for the three months ended December 31, 2015, as compared to the three months ended December 31, 2014. This was a result of a decrease of \$4.2 million in new system order volume added as the total number of system orders decreased from the same prior year period. The TomoTherapy System order volume decreased in this period partially offset by an increase in orders for the CyberKnife System fueled by the demand for the MLC, introduced in the third quarter of fiscal 2015. The remaining change was a result of fewer upgrade orders added in the three months ended December 31, 2015 as compared to the same prior year period.

Gross orders increased by \$1.0 million for the six months ended December 31, 2015, as compared to the six months ended December 31, 2014. This was a result of increased CyberKnife System order volume as compared to the same prior year period, partially offset by a slight decrease in TomoTherapy System order volume. The increase in CyberKnife System orders is in line with the increased demand for systems with the MLC, after its introduction in the third quarter of fiscal 2015. The majority of new orders added for CyberKnife Systems this period were for systems with the MLC.

Net orders increased by \$1.2 million for the three months ended December 31, 2015, as compared to the three months ended December 31, 2014, resulting from \$3.9 million of fewer cancellations and more favorable currency impact causing an increase of \$3.4 million compared to the same period in prior year. These increases were partially offset by the decrease in gross orders of \$5.2 million and a slight increase in age-outs of \$0.9 million as compared to the same period in the prior year.

- Age-outs were \$19.1 million and \$18.1 million in the three months ended December 31, 2015 and 2014, respectively. The age-outs of \$19.1 million for the three months ended December 31, 2015 resulted from the age-out of two additional systems as compared to the prior year period.

- Cancellations were \$3.0 million and \$6.9 million in the three months ended December 31, 2015 and 2014, respectively. Cancellations are outside of our control and difficult to forecast; however, we continue to work closely with our customers to minimize the impact of cancellations on our business.

- Currency impacts resulted in decreases in net orders of \$2.3 million and \$5.8 million in the three months ended December 31, 2015 and 2014, respectively.

Net orders increased by \$13.7 million for the six months ended December 31, 2015, as compared to the six months ended December 31, 2014, resulting from the increase in gross orders of \$1.0 million plus an increase of \$10.8 million due to foreign currency impacts and an increase of \$3.5 million due to fewer cancellations. These increases were partially offset by higher age-outs resulting in a decrease of \$1.6 million.

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- Age-outs were \$37.5 million and \$35.9 million in the six months ended December 31, 2015 and 2014, respectively. The age-outs of \$37.5 million for the six months ended December 31, 2015 include \$5.3 million of age-ins which represent orders that previously aged-out but have been taken to revenue in the current period. There were no age-ins included in the age-out number for the six months ended December 31, 2014.
- Cancellations were \$6.0 million and \$9.5 million in the six months ended December 31, 2015 and 2014, respectively. Cancellations are outside of our control and difficult to forecast; however, we continue to work closely with our customers to minimize the impact of cancellations on our business.
- Currency impacts resulted in decreases in net orders of \$1.1 million and \$11.9 million in the three months ended December 31, 2015 and 2014, respectively.

Currently, we expect age-outs in the third quarter of this fiscal year to be in the range of \$5.0 to \$8.0 million as compared to \$11.6 million in age-outs recorded during the three months ended March 31, 2015. Between fiscal 2013 and 2015, we made changes to our order taking process, including increased oversight responsibility for and management of distributors and changes in timing as to when we enter some of our distributor orders into backlog. We believe these changes will improve the quality of backlog over time and reduce the level of age-outs.

Results of Operations Three and six months ended December 31, 2015 and 2014

(Dollars in thousands)	Three Months Ended December 31,					Six Months Ended December 31,				
	2015	2014	2015-2014	2015	2014	2015-2014	2015	2014	2015-2014	
	Amount	% (a)	Amount	% (a)	% change	Amount	% (a)	Amount	% (a)	% change
Products	\$ 55,759	51%	\$ 47,650	49%	17%	\$ 95,754	48%	\$ 80,665	45%	19%
Services	53,153	49	50,505	51	5	102,789	52	99,871	55	3
Net revenue	\$ 108,912	100%	\$ 98,155	100%	11%	\$ 198,543	100%	\$ 180,536	100%	10%
Gross profit	\$ 42,571	39%	\$ 38,489	39%	11%	\$ 76,469	39%	\$ 66,290	37%	15%
Products gross profit	23,042	41	20,479	43	13	40,020	42	32,829	41	22
Services gross profit	19,529	37	18,010	36	8	36,449	35	33,461	34	9
Research and development expenses	14,931	14	13,917	14	7	29,227	15	28,066	16	4
Selling and marketing expenses	15,076	14	15,802	16	(5)	28,493	14	33,776	19	(16)
General and administrative expenses	12,688	12	12,361	13	3	26,104	13	23,311	13	12
Other expense, net	5,070	5	5,528	6	(8)	10,161	5	10,989	6	(8)
Provision for income taxes	833	1	873	1						