VARIAN MEDICAL SYSTEMS INC
Form 10-Q
February 05, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended December 28, 2007

or

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

Commission File Number 1-7598

VARIAN MEDICAL SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

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

(650) 493-4000

(Registrant s telephone number, including area code)

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 125,675,820 shares of common stock, par value $1 per share, outstanding as of January 25, 2008.

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VARIAN MEDICAL SYSTEMS, INC.

FORM 10-Q for the Quarter Ended December 28, 2007

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

(In thousands, except per share amounts)	Three Months Ended December 28, 2007	Three Months Ended December 29, 2006
Revenues:		
Product	$ 364,336	$ 317,823
Service contracts and other	94,197	70,035
Total revenues	458,533	387,858
Cost of revenues:		
Product	214,560	190,933
Service contracts and other	53,127	36,775
Total cost of revenues	267,687	227,708
Gross margin	190,846	160,150
Operating expenses:		
Research and development	29,039	26,966
Selling, general and administrative	77,471	63,142
Total operating expenses	106,510	90,108
Operating earnings	84,336	70,042
Interest income	2,810	3,488
Interest expense	(1,296)	(1,042)
Earnings from operations before taxes	85,850	72,488
Taxes on earnings	30,371	22,987
Net earnings	$ 55,479	$ 49,501
Net earnings per share - Basic	$ 0.44	$ 0.38
Net earnings per share - Diluted	$ 0.43	$ 0.37
Weighted average shares used in the calculation of:		
Net earnings per share - Basic	124,809	129,198
Net earnings per share - Diluted	127,793	132,963

See accompanying notes to the condensed consolidated financial statements.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except par values)	December 28, 2007	September 28, 2007 (1)
Assets		
Current assets:		
Cash and cash equivalents	$ 334,082	$ 263,246
Accounts receivable, net of allowance for doubtful accounts of $3,802 at December 28, 2007 and $3,859 at September 28, 2007	438,132	507,040
Inventories	259,571	233,743
Prepaid expenses and other current assets	60,401	49,590
Deferred tax assets	125,538	106,610
Total current assets	1,217,724	1,160,229
Property, plant and equipment, net	180,876	171,654
Goodwill	208,844	205,553
Other assets	156,751	146,939
Total assets	$ 1,764,195	$ 1,684,375
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 96,977	$ 92,600
Accrued expenses	245,419	299,052
Deferred revenues	124,923	101,839
Short-term borrowings	18,000	41,000
Current maturities of long-term debt	8,974	8,970
Product warranty	52,971	51,290
Advance payments from customers	180,090	186,936
Total current liabilities	727,354	781,687
Long-term debt	40,329	40,386
Other long-term liabilities	133,629	40,847
Total liabilities	901,312	862,920
Commitments and contingencies (Note 8)		
Stockholders equity:		
Preferred stock of $1 par value: 1,000 shares authorized; none issued and outstanding		
Common stock of $1 par value: 189,000 shares authorized; 125,486 and 125,215 shares issued and outstanding at December 28, 2007 and at September 28, 2007, respectively	125,486	125,215
Capital in excess of par value	346,926	311,411
Retained earnings	400,448	395,742
Accumulated other comprehensive loss	(9,977)	(10,913)
Total stockholders equity	862,883	821,455
Total liabilities and stockholders equity	$ 1,764,195	$ 1,684,375

(1) The condensed consolidated balance sheet as of September 28, 2007 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.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)	Three Months Ended December 28, 2007	December 29, 2006
Cash flows from operating activities:		
Net earnings	$ 55,479	$ 49,501
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Tax benefits from exercises of share-based payment awards	11,872	8,171
Excess tax benefits from share-based compensation	(10,803)	(7,632)
Share-based compensation expense	9,410	10,946
Depreciation	7,448	6,056
Provision for doubtful accounts receivable	(42)	(34)
Loss on disposal of property, plant and equipment	7	41
Amortization of intangible assets	1,198	1,257
Amortization of premium/discount on marketable securities, net		21
Deferred taxes	(1,077)	(684)
Net change in fair value of derivatives and underlying commitments	(2,113)	(2,240)
(Income)/Expense on equity investment in affiliate	984	(17)
Other	(674)	
Changes in assets and liabilities:		
Accounts receivable	74,446	81,200
Inventories	(24,671)	(34,041)
Prepaid expenses and other current assets	(9,843)	(1,314)
Accounts payable	(319)	(5,418)
Accrued expenses	(12,111)	(21,243)
Deferred revenues	23,084	(5,012)
Product warranty	1,715	1,746
Advance payments from customers	(7,360)	793
Other long-term liabilities	4,068	691
Net cash provided by operating activities	120,698	82,788
Cash flows from investing activities:		
Proceeds from maturities or sale of marketable securities		60,000
Purchases of marketable securities		(65,000)
Purchases of property, plant and equipment	(16,592)	(12,191)
Equity investment in affiliate		(4,543)
(Increase)/Decrease in cash surrender value of life insurance	399	(3,480)
Note receivable from affiliate and other	317	(3,352)
Proceeds from disposal of property, plant and equipment	46	638
Other, net	(1,775)	33
Net cash used in investing activities	(17,605)	(27,895)
Cash flows from financing activities:		
Repurchases of common stock	(41,196)	(76,645)
Proceeds from issuance of common stock to employees	24,350	9,999
Excess tax benefits from share-based compensation	10,803	7,632
Repayments under line of credit agreement	(23,000)	
Employees taxes withheld and paid for restricted performance shares and restricted stock	(310)	(53)

Repayments of bank borrowings	(53)	(49)
Net cash used in financing activities	(29,406)	(59,116)
Effects of exchange rate changes on cash and cash equivalents	(2,851)	(4,019)
Net increase (decrease) in cash and cash equivalents	70,836	(8,242)
Cash and cash equivalents at beginning of period	263,246	272,508
Cash and cash equivalents at end of period	$ 334,082	$ 264,266

See accompanying notes to the condensed consolidated financial statements.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Varian Medical Systems, Inc. (VMS) and subsidiaries (collectively, the Company) designs, manufactures, sells and services advanced equipment and software products for treating cancer with focused energy beams, or radiation. The Company also designs, manufactures, sells and services high quality, cost-effective X-ray tubes for original equipment manufacturers; replacement X-ray tubes; flat panel digital image detectors for filmless X-rays (commonly referred to as flat panel detectors or digital image detectors) for medical, dental, veterinary, scientific and industrial applications; linear accelerators, image detectors, image processing software and image detection systems for security and inspection purposes; and proton therapy systems for cancer treatment and scientific instruments used in fundamental and applied physics research.

Fiscal Year

The Company s fiscal year is the 52- or 53-week period ending on the Friday nearest September 30. Fiscal year 2008 is the 52-week period ending September 26, 2008, and fiscal year 2007 was the 52-week period ended September 28, 2007. The fiscal quarters ended December 28, 2007 and December 29, 2006 were both 13-week periods.

Principles of Consolidation

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

Basis of Presentation

The condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and note disclosures normally included in financial statements prepared in accordance with 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 September 28, 2007. In the opinion of management, the condensed consolidated financial statements herein include adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company s financial position as of December 28, 2007 and September 28, 2007, results of operations for the three months ended December 28, 2007 and December 29, 2006, and cash flows for the three months ended December 28, 2007 and December 29, 2006. The results of operations for the three months ended December 28, 2007 are not necessarily indicative of the operating results to be expected for the full fiscal year or any future periods.

Use of Estimates

The preparation of financial statements in conformity with 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.

Revenue Recognition

The Company s revenues are derived primarily from the sale of hardware and software products, and related services and contracts from the Company s Oncology Systems, X-ray Products, Security and Inspections (SIP) businesses, as well as proton therapy and scientific research instruments products. The Company currently records its revenues net of any value added or sales tax.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

Hardware Products

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

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

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

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

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

Software Products

Except as described below under Other, the Company recognizes revenues for software products in accordance with Statement of Position (SOP) No. 97-2, *Software Revenue Recognition* (SOP 97-2), as amended by SOP No. 98-9, *Software Revenue Recognition with Respect to Certain Agreements*. The Company recognizes license revenues when all of the following criteria are met: persuasive evidence of an arrangement exists, the vendor s fee is fixed or determinable, collection of the related receivable is probable, delivery of the product has occurred and the Company has received from the customer an acceptance form acknowledging installation and substantial conformance with the Company s specifications (as set forth in the user manual) for such product, or upon verification of installation when customer acceptance is not required to be received, or upon the expiration of an acceptance period, provided that all other criteria for revenue recognition under SOP 97-2 have been met. Revenues

earned on software arrangements involving multiple elements are allocated to each element

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

based on vendor-specific objective evidence of the fair value (VSOE), which is based on the price charged when the same element is sold separately. In instances when evidence of VSOE of all undelivered elements exists, but evidence does not exist for one or more delivered elements, revenues are recognized using the residual method. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue. Revenue allocated to maintenance and support is recognized ratably over the maintenance term (typically one year).

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

The Company does not have installation obligations for certain software products in the SIP business and certain brachytherapy software products. For software products that do not include installation obligations, the Company recognizes revenues upon the transfer of risk of loss, which is either at the time of shipment or delivery, depending upon the shipping terms of the contract, provided that all other criteria under SOP 97-2 are met.

Other

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

Revenues related to certain highly customized scientific research instrument products and proton therapy commissioning service contracts, as well as highly customized image detection systems are recognized using the percentage-of-completion method in accordance with SOP No. 81-1, *Accounting for Performance of Construction-Type and Certain Product Type Contracts*. Revenues recognized under the percentage-of-completion method are primarily based on contract costs incurred to date compared with total estimated contract costs. Estimated losses on contracts are charged to cost of sales in the period when the loss is identified.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 will be effective for the Company beginning in the first quarter of fiscal year 2009. The Company is currently assessing the impact that SFAS 157 may have on its consolidated financial position, results of operations and cash flows.

In September 2006, the FASB issued SFAS No. 158, *Employer s Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R)* (SFAS 158). SFAS 158 requires the Company to (a) recognize a plan s funded status in its statement of financial position, (b) measure a plan s assets and the obligations that determine its funded status as of the end of the Company s fiscal year and (c) recognize changes in the funded status of a defined benefit plan in the year in which the changes occur through other comprehensive income. The Company adopted the requirement to recognize the funded status of a defined benefit plan and the disclosure requirements in the fourth quarter of fiscal year 2007. Please refer to Note 10 Retirement Plans in the Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the fiscal year ended September 28, 2007 for a discussion of the effects of adopting the recognition provisions and disclosure requirements of SFAS 158. The Company is not required to adopt the measurement date provisions until fiscal year 2009. The Company is assessing the potential impact, if any, that the measurement date provision of SFAS 158 may

have on its consolidated financial position, results of operations or cash flows.

Based on the evaluation to date, the Company does not believe the adoption of the measurement date provisions of SFAS 158 will have a material impact on its financial statements.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

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

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS 141R). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective for the Company in the first quarter of fiscal year 2010. The Company is currently assessing the potential impact, if any, of the adoption of SFAS 141R on its consolidated financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51* (SFAS 160). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent s, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent s ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective for the Company in the first quarter of fiscal year 2010. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS 160 on its consolidated financial position, results of operations and cash flows.

2. BALANCE SHEET COMPONENTS:

The components of inventories are as follows:

(In millions)	December 28, 2007	September 28, 2007
Raw materials and parts	$ 139.5	$ 124.2
Work-in-progress	44.0	41.5
Finished goods	76.1	68.0
Total inventories	$ 259.6	$ 233.7

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

(In millions)	December 28, 2007	September 28, 2007
Long-term income taxes payable	$ 92.6	$
Other	41.0	40.8
Total other long-term liabilities	$ 133.6	$ 40.8

The Other category primarily consisted of accruals for environmental costs, accrued pension and post-retirement benefits and deferred income tax liabilities.

As a result of the adoption of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48), liability for unrecognized tax benefits were reclassified to Other Long-term Liabilities from Accrued Expenses. Please refer to the further discussion of the adoption of FIN 48 in Note 10 Income Taxes.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

3. GOODWILL AND INTANGIBLE ASSETS

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

(In millions)	December 28, 2007	September 28, 2007
Intangible Assets:		
Acquired existing technology	$ 21.1	$ 21.1
Patents, licenses and other	14.5	14.2
Customer contracts and supplier relationships	10.5	10.2
Accumulated amortization	(30.7)	(29.5)
Net carrying amount	$ 15.4	$ 16.0

Amortization expense for intangible assets required to be amortized under SFAS No.142, *Goodwill and Other Intangible Assets* (SFAS 142) was $1.2 million for the three months ended December 28, 2007 and $1.3 million for the three months ended December 29, 2006. At December 28, 2007, the Company estimated amortization expense on a straight-line basis for the remaining nine months of fiscal year 2008, fiscal years 2009 through 2012, and thereafter, to be as follows (in millions): $3.3, $3.7, $3.1, $2.4, $1.5 and $1.4.

The following table reflects goodwill allocated to the Company s reportable segments and the Other category:

(In millions)	December 28, 2007	September 28, 2007
Oncology Systems	$ 125.0	$ 125.0
X-ray Products	2.7	0.5
Other	81.1	80.1
Total	$ 208.8	$ 205.6

4. RELATED PARTY TRANSACTIONS

In fiscal years 1999 and 2000, VMS invested a total of $5 million in a three member consortium for a 20% ownership interest in dpiX Holding LLC (dpiX Holding), which in turn invested $25 million for an 80.1% ownership interest in dpiX LLC (dpiX), a supplier of amorphous silicon based thin-film transistor arrays (flat panels) for the Company s X-ray Products digital imaging subsystems and for its Oncology Systems On-Board Imager and PortalVision imaging systems. VMS had the right to appoint one manager of the five person board of managers and the investment was accounted for under the equity method. In accordance with the dpiX Holding agreement, net losses were to be allocated to the other two members, in succession, until their capital accounts equaled zero, then to the three members in accordance with their ownership interests. The dpiX Holding agreement also provided that net profits were to be allocated to the other two members, in succession, until their capital accounts equaled the net losses previously allocated, then to the three members in accordance with their ownership interests.

In September 2004, VMS acquired another member s 20% ownership interest in dpiX Holding for $1 million. As a result, VMS has the right to appoint two managers of the five person board of managers and its ownership interest in dpiX Holding increased to 40% with the remaining

60% being held by the other original member. When VMS acquired this additional 20% ownership interest, the capital account of the selling member was nearly zero because it was the first in the consortium to be allocated losses. As a result, when dpiX Holding recorded net profits after VMS acquired the additional 20% ownership interest, VMS was the first to be allocated net profits to recover previously allocated losses. In the three months ended December 28, 2007, VMS recorded a loss on the equity investment in dpiX Holding of $1.0 million. In the three months ended December 29, 2006, VMS recorded income on the equity investment in dpiX Holding of $17,000. Incomes and losses on the equity investment in dpiX Holding are included in Selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

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

In December 2004, VMS agreed to loan $2 million to dpiX in four separate installments, bearing interest at prime rate plus 1% per annum. The principal balance is due and payable to VMS in twelve equal quarterly installments that began in October 2006; interest is payable in full according to the same quarterly schedule, that began in April 2005; and the entire principal balance, together with accrued and unpaid interest thereon and all other related amounts payable hereunder, is due and payable on July 10, 2009. The note receivable from dpiX totaled $1.2 million and $1.3 million at December 28, 2007 and September 28, 2007, respectively. The current portion was included in Prepaid Expense and Other Current Assets and the long-term portion was included in Other Assets in the Condensed Consolidated Balance Sheet.

In March 2006, VMS and the other member of dpiX Holding agreed to invest an aggregate $92 million in dpiX Holding, with each member s contribution based on its percentage ownership interest in dpiX Holding, for dpiX to acquire and construct a manufacturing facility in Colorado to increase its production capacity. As of December 28, 2007 and September 28, 2007, VMS s contribution of $36.8 million to dpiX Holding for the construction of the Colorado manufacturing facility was included in Other assets in the Condensed Consolidated Balance Sheet.

During the three months ended December 28, 2007 and December 29, 2006, the Company purchased flat panels from dpiX totaling approximately $5.5 million and $6.5 million, respectively, which are included as a component of Inventory in the Condensed Consolidated Balance Sheets and Cost of revenues - product in the Condensed Consolidated Statements of Earnings for these periods.

5. PRODUCT WARRANTY

The Company provides for estimated future costs of warranty obligations in accordance with FASB Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* which requires an entity to disclose and recognize a liability for the fair value of the obligation it assumes upon issuance of a guarantee. The Company warrants most of its products for a specific period of time, usually one year, against material defects. The Company provides for the estimated future costs of warranty obligations in cost of revenues when the related revenues are recognized. The accrued warranty costs represent the best estimate at the time of sale of the total costs that the Company will incur to repair or replace product parts that fail while still under warranty. The amount of the accrued estimated warranty costs obligation for established products is primarily based on historical experience as to product failures adjusted for current information on repair costs. For new products, estimates include the historical experience of similar products, as well as reasonable allowance for start-up expenses. On a quarterly basis, the Company reviews the accrued warranty costs and updates the historical warranty cost trends, if required.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

The following table reflects the change in the Company s accrued product warranty during the three months ended December 28, 2007 and December 29, 2006:

	Three Months Ended	
(In millions)	**December 28, 2007**	**December 29, 2006**
Accrued product warranty, at beginning of period	$ 51.3	$ 43.0
Charged to cost of revenues	12.5	10.0
Actual product warranty expenditures	(10.8)	(8.2)
Accrued product warranty, at end of period	$ 53.0	$ 44.8

6. LINE OF CREDIT

In July 2007, the Company entered into a Credit Agreement with Bank of America, N.A. (BofA), providing for an unsecured revolving credit facility that enables the Company to borrow and have outstanding at any given time a maximum of $100 million (the Credit Facility). Borrowings under of the Credit Facility may be used for working capital, capital expenditures, permitted acquisitions and other lawful corporate purposes. The Credit Facility will expire, if not extended by mutual agreement of the Company and BofA, on July 27, 2009. Borrowings under the Credit Facility accrue interest either (i) based on the London InterBank Offered Rate (LIBOR) plus a margin of .45% to .70% based on a leverage ratio involving funded indebtedness and earnings before interest, tax and depreciation and amortization (EBITDA) or (ii) based upon a base rate of either the federal funds rate plus .5% or BofA s announced prime rate, whichever is greater, plus a margin of 1.75% to 2.25% based on a leverage ratio involving funded indebtedness and EBITDA, depending upon instructions from the Company to BofA. The Company may select borrowing periods of one, two, three or six months for advances based on the LIBOR rate. Interest rates on advances based on the base rate are adjustable daily. The Company may prepay, reduce or terminate the commitment without penalty. The Company pays commitment fees at an annual rate of ..1% to .15% based on a leverage ratio involving funded indebtedness and EBITDA. The Credit Facility also provides $25 million to support letters of credit issued on behalf of the Company, of which none were outstanding as of December 28, 2007.

At December 28, 2007, the outstanding balance on the Credit Facility was $18 million with a weighted average interest rate of 5.70%. At September 28, 2007, $41 million was outstanding under the Credit Facility with a weighted average interest rate of 6.04%.

The Credit Facility contains customary affirmative and negative covenants for facilities of this type. The Company has also agreed to maintain certain financial covenants relating to (i) leverage ratios involving funded indebtedness and EBITDA, (ii) liquidity and (iii) consolidated assets. As of December 28, 2007 and September 28, 2007, the Company was in compliance with all covenants.

7. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company has significant transactions denominated in foreign currencies and addresses certain of those financial exposures through a program of risk management that includes the use of derivative financial instruments. The Company sells products throughout the world, often in the currency of the customer s country, and typically hedges certain of these larger foreign currency sales orders when they are not in the subsidiaries functional currency. These foreign currency sales orders that fit our risk management policy criteria are hedged using forward contracts. The Company may use other derivative instruments in the future. The Company enters into forward contracts primarily to reduce the effects of fluctuating foreign currency exchange rates. The Company does not enter into forward contracts for speculative or trading purposes. The forward contracts range from one to twelve months in maturity. As of December 28, 2007, the Company did not have any forward contracts with an original maturity greater than twelve months. As international deliveries may extend beyond twelve months, the Company may hedge beyond twelve months in the future.

The Company accounts for its hedges of foreign currency denominated sales orders (firm commitments) as fair value hedges as prescribed by SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 149, *Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities* (SFAS 133). For the three

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

months ended December 28, 2007, there were no material gains or losses due to hedge ineffectiveness. At December 28, 2007, the Company had forward contracts for fair value hedges with notional values to sell and purchase of $175.0 million and $13.7 million, respectively, in various foreign currencies. At December 28, 2007, substantially all of the open forward contracts were deemed effective.

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

Changes in the values of these hedging instruments are offset by changes in the values of foreign currency denominated assets and liabilities. Variations from the forecasted foreign currency assets or liabilities, coupled with a significant currency movement, may result in a material gain or loss if the hedges are not effectively offsetting the change in value of the foreign currency denominated asset or liability. Other than foreign exchange hedging activities, the Company has no other freestanding or embedded derivative instruments.

8. COMMITMENTS AND CONTINGENCIES

Environmental Remediation Liabilities

The U.S. Environmental Protection Agency (EPA) or third parties have named the Company as a potentially responsible party (PRP) under the Comprehensive Environmental Response Compensation and Liability Act of 1980, as amended (CERCLA), at nine sites where the Company, as Varian Associates, Inc., was alleged to have shipped manufacturing waste for recycling or disposal and, as a PRP, the Company may have an obligation to reimburse the EPA or other third parties for cleanup costs at these sites. In addition, the Company is overseeing environmental cleanup projects and, as applicable, reimbursing third parties for cleanup activities under the direction of, or in consultation with, federal, state and/or local agencies at certain current VMS or former Varian Associates, Inc. facilities. Under the terms of the agreement governing the spin-offs of Varian, Inc. (VI) and Varian Semiconductor Equipment Associates, Inc. (VSEA), by the Company in 1999, VI and VSEA are each obligated to indemnify the Company for one-third of these environmental cleanup costs (after adjusting for any insurance proceeds realized or tax benefits recognized by the Company). The Company spent $0.3 million and $0.2 million (net of amounts borne by VI and VSEA) during the three months ended December 28, 2007 and December 29, 2006, respectively, on environmental cleanup costs, third-party claim costs, project management costs and legal costs.

Various uncertainties make it difficult to estimate the likelihood or cost of project management costs, legal costs and costs of certain third-party claims at all of the sites and facilities. In addition, for the nine sites and one of the facilities, various uncertainties make it difficult to assess the likelihood and scope of further cleanup activities or to estimate the future cost of such activities. As of December 28, 2007, the Company nonetheless estimated that the Company s future exposure (net of VI s and VSEA s indemnification obligations) for the cleanup costs for these ten locations, as well as project management costs, legal costs and the costs of certain third party-claims for all locations ranged in the aggregate from $3.3 million to $7.5 million. Management believes that no amount in the range of estimated future costs is more probable of being incurred than any other amount in the range and therefore accrued $3.3 million for these cleanup projects as of December 28, 2007. The amount accrued has not been discounted to present value due to the uncertainties that make it difficult to develop a best estimate of future costs.

As to all other facilities, the Company has gained sufficient knowledge to better estimate the scope and costs of future cleanup activities based upon formal agreements with other parties defining the Company s future liabilities or formal cleanup plans that have either been approved by or completed in accordance with the requirements of the state or federal environmental agency with jurisdiction over the facility. As of December 28, 2007, the Company estimated that the Company s future exposure (net of VI s and VSEA s indemnification obligations) for the cleanup costs at these facilities, and reimbursements of third party s claims for these facilities, ranged in the aggregate from $8.5 million to $36.6 million. The time frames over which these cleanup project costs are estimated vary, ranging from 2 years to 30 years as of December 28, 2007. As to each of these facilities, management determined that a particular amount within the range of estimated costs was

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

a better estimate of the future environmental liability than any other amount within the range, and that the amount and timing of these future costs were reliably determinable. The best estimate within the range was $16.6 million at December 28, 2007. The Company accordingly accrued $11.6 million, which represents its best estimate of the future costs of $16.6 million discounted at 4%, net of inflation. This accrual is in addition to the $3.3 million described in the preceding paragraph.

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

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

The Company evaluates its liability for environmental-related investigation and cleanup costs in light of the liability and financial strength of potentially responsible parties and insurance companies with respect to which the Company believes that it has rights to contribution, indemnity and/or reimbursement (in addition to the obligations of VI and VSEA). Claims for recovery of environmental investigation and cleanup costs already incurred, and to be incurred in the future, have been asserted against various insurance companies and other third parties. The Company receives certain cash payments in the form of settlements and judgments from defendants, its insurers and other third parties from time to time. The Company has also reached an agreement with an insurance company under which that insurance company agreed to pay a portion of the Company s past and future environmental-related expenditures. Accordingly, the Company recorded a receivable of $2.9 million at each of December 28, 2007 and September 28, 2007, which was primarily included in Other assets in the Condensed Consolidated Balance Sheets. The Company believes that this receivable is recoverable because it is based on a binding, written settlement agreement with a solvent and financially viable insurance company and the insurance company has in the past paid the claims that the Company has made.

Acquisition-Related Commitments/Obligations

When the Company acquired ACCEL Instruments GmbH (ACCEL) in January 2007, ACCEL was involved in a contract-related lawsuit. Subsequent to the acquisition, the Company settled this lawsuit and agreed to perform under a new contract for a fixed price. From January to September 2007, the Company gathered information related to the expected cost of satisfying its contract commitment and completed its assessment as of September 28, 2007. As a result, the final purchase price allocation of ACCEL included a loss accrual related to this contingency of 28.3 million, or approximately $40 million. If the actual costs related to the contingency exceed the estimated amount or if the estimated loss increases, the variances will be recognized in the Consolidated Statement of Earnings in the periods these variances arise. As of December 28, 2007, the actual costs incurred were consistent with the estimated costs for the contract.

Other Proceedings

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

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

9. RETIREMENT PLANS

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

	Three Months Ended	
(In thousands)	December 28, 2007	December 29, 2006
Defined Benefit Plans		
Service cost	$ 457	$ 1,185
Interest cost	1,305	1,043
Expected return on plan assets	(1,532)	(1,127)
Amortization of prior service cost	36	31
Recognized actuarial loss	129	236
Net pension benefit cost	$ 395	$ 1,368
Post-Retirement Benefit Plans		
Interest cost	$ 92	$ 94
Amortization of transition amount	123	123
Amortization of prior service cost	1	1
Recognized actuarial loss	4	5
Net pension benefit cost	$ 220	$ 223

The Company made contributions to the defined benefit plans of $1.1 million during the three months ended December 28, 2007. The Company currently expects total contributions to the defined benefit plans for fiscal year 2008 will be approximately $3.1 million. The Company made contributions to the post-retirement benefit plans of $0.1 million during the three months ended December 28, 2007. The Company currently expects total contributions to the post-retirement benefit plans for fiscal year 2008 will be approximately $0.6 million.

10. INCOME TAXES

Effective as of the beginning of the first quarter of fiscal year 2008, the Company adopted the provisions of FIN 48. FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with FASB Statement No. 109, Accounting for Income Taxes. 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.

As a result of the adoption of FIN 48, the Company decreased retained earnings by $19.1 million. The total amount of gross unrecognized tax benefits as of the date of adoption was $76.7 million. Of this amount, $50.9 million would affect the effective tax rate if recognized. The difference would be offset by changes to deferred tax assets and liabilities.

The Company historically classified unrecognized tax benefits in current taxes payable, which is included in Accrued Expenses. As a result of adoption of FIN 48, the Company reclassified unrecognized tax benefits to Other Long-term Liabilities.

The Company s policy to include interest and penalties related to unrecognized tax benefits within the provision for taxes on the Condensed Consolidated Statements of Earnings did not change as a result of adopting FIN 48. As of the date of adoption of FIN 48, the Company had accrued $12.7 million for the payment of interest and penalties relating to unrecognized tax benefits.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

The amount of unrecognized tax benefits did not change by a significant amount during the first quarter of fiscal year 2008. The Company does not anticipate a significant change to the total amount of unrecognized tax benefits within the next 12 months.

The Company files U.S. federal, U.S. state, and foreign tax returns. The Company s U.S. federal tax returns are generally no longer subject to tax examinations for years prior to 2003. The Company has significant operations in Switzerland. The Company s Swiss tax returns are generally no longer subject to tax examinations for years prior to 2003. For U.S. state and other foreign tax returns, the Company is generally no longer subject to tax examinations for years prior to 2002.

The Company s effective tax rate was 35.4% in the first quarter of fiscal year 2008 compared to 31.7% in the same period of fiscal year 2007. The increase was primarily due to: (i) the application of the principles and methodologies of FIN 48 to our current period activity, including the recognition of interest expense and penalties, classified as tax expense, for tax positions taken relative to the current and prior periods, which resulted in an addition to the liability for uncertain tax positions, and (ii) the inclusion in the year-ago period of a tax benefit associated with the retrospective reinstatement of the federal research and development tax credit, which had previously expired on December 31, 2005.

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 that the U.S. federal rate, and the Company s domestic earnings are subject to state income taxes.

11. STOCKHOLDERS EQUITY

Stock Repurchase Program

On July 24, 2007, VMS s Board of Directors approved the repurchase up to 12,000,000 shares of VMS common stock during the period beginning on July 30, 2007 through December 31, 2008. During the three months ended December 28, 2007, the Company paid $41.2 million to repurchase 920,000 shares of VMS common stock. All shares that have been repurchased have been retired. As of December 28, 2007, the Company could repurchase up to an additional 10,080,000 shares of VMS common stock under the July 24, 2007 authorization.

Comprehensive Earnings

The components of comprehensive earnings are as follows:

	Three Months Ended	
(In thousands)	**December 28, 2007**	**December 29, 2006**
Net earnings	**$ 55,479**	**$ 49,501**
Other comprehensive income, net of tax:		
Defined benefit pension and post-retirement benefit plans:		
Amortization of transition obligation included in net periodic benefit cost	75	
Amortization of prior service cost included in net periodic benefit cost	32	
Amortization of net actuarial loss included in net periodic benefit cost	95	
	202	
Currency translation adjustment	734	
Other comprehensive income	**936**	

Total comprehensive earnings	**$ 56,415**	**$ 49,501**

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

12. EMPLOYEE STOCK PLANS

The table below summarizes the share-based compensation expense under SFAS 123(R), *Share-Based Payment* (SFAS 123(R)):

	Three Months Ended	
(In thousands, except per share amounts)	**December 28, 2007**	**December 29, 2006**
Cost of revenues - Product	$ 1,016	$ 1,146
Cost of revenues - Service contracts and other	780	866
Research and development	1,048	1,348
Selling, general and administrative	6,566	7,586
Taxes on earnings	(3,145)	(3,744)
Net decrease in net earnings	$ 6,265	$ 7,202
Increase (decrease) on:		
Cash flows from operating activities	$ (10,803)	$ (7,632)
Cash flows from financing activities	$ 10,803	$ 7,632

During the three months ended December 28, 2007, total share-based compensation expense recognized in earnings before taxes was $9.4 million and the total related recognized tax benefit was $3.1 million. During the three months ended December 29, 2006, total share-based compensation expense recognized in earnings before taxes was $10.9 million and the total related recognized tax benefit was $3.7 million. Total share-based compensation expense capitalized as part of inventory was $0.6 million for both the three months ended December 28, 2007 and December 29, 2006.

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

	Three Months Ended	
	December 28, 2007	**December 29, 2006**
Employee Stock Option Plans		
Expected term (in years)	4.20	4.31
Risk-free interest rate	3.1%	4.6%
Expected volatility	29.8%	29.3%
Expected dividend		
Weighted average fair value at grant date	$ 14.31	$ 16.02
Employee Stock Purchase Plan		
Expected term (in years)	0.50	0.50
Risk-free interest rate	3.4%	5.0%
Expected volatility	22.0%	22.3%
Expected dividend		
Weighted average fair value at grant date	$ 9.25	$ 11.18

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

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

		Options Outstanding			
(In thousands, except per share amounts)	**Shares Available for Grant**	**Number of Shares**	**Weighted Average Exercise Price**	**Weighted-Average Remaining Contractual Term (in years)**	**Aggregate Intrinsic Value (3)**
Balance at September 28, 2007	3,304	15,585	$ 33.75		
Granted (1)	(60)	26	49.31		
Cancelled or expired (2)	65	(45)	49.18		
Exercised		(1,184)	20.56		
Balance at December 28, 2007	3,309	14,382	$ 34.81	5.9	$ 259,870
Exercisable at December 28, 2007		12,000	$ 31.77	5.4	$ 253,387

(1) During the three months ended December 28, 2007, VMS granted certain employees an aggregate of 9,500 shares of restricted common stock and awarded to its newly appointed director an aggregate of 4,000 deferred stock units under the Second Amended and Restated 2005 Omnibus Stock Plan.

(2) During the three months ended December 28, 2007, VMS cancelled 6,400 shares of restricted common stock that were tendered to VMS for employees taxes withheld for vested restricted common stock under the Amended and Restated 2005 Omnibus Stock Plan. In addition, VMS cancelled 1,000 deferred stock units granted under the Second Amended and Restated 2005 Omnibus Stock Plan to a director who resigned during the first quarter of fiscal year 2008. During the three months ended December 28, 2007, VMS cancelled stock options for 1,116 shares that were granted prior to the spin-offs of VI and VESA and that do not become available for grant upon cancellation.

(3) The aggregate intrinsic value represents the total pre-tax intrinsic value, which is computed based on the difference between the exercise price and VMS s closing common stock price of $52.82 as of December 28, 2007 and which would have been received by the option holders had all option holders exercised their options as of that date.

As of December 28, 2007, there was $27 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 performance shares and deferred stock units is summarized as follows:

(In thousands, except per share amounts)	**Shares**	**Weighted Average Grant-Date Fair Value**
Balance at September 28, 2007	348	$ 44.38

Granted	13		49.31
Vested	(21)		51.55
Cancelled or expired	(1)		49.74
Balance at December 28, 2007	339	$	44.12

As of December 28, 2007, unrecognized compensation expense totaling $11.9 million was related to restricted stock and deferred stock units. This unrecognized compensation expense is expected to be recognized over a weighted average period of 4.9 years.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

13. EARNINGS PER SHARE

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

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

	Three Months Ended	
(In thousands, except per share amounts)	**December 28, 2007**	**December 29, 2006**
Net earnings	$ 55,479	$ 49,501
Basic weighted average shares outstanding	124,809	129,198
Dilutive effect of potential common shares	2,984	3,765
Diluted weighted average shares outstanding	127,793	132,963
Net earnings per share Basic	$ 0.44	$ 0.38
Net earnings per share Diluted	$ 0.43	$ 0.37

Pursuant to SFAS 123(R), the Company excludes shares underlying stock options from the computation of diluted weighted average shares outstanding if the per share value, including the sum of (a) the exercise price of the options and (b) the amount of the compensation cost attributed to future services and not yet recognized, is greater than the average market price of the shares, because the inclusion of the shares underlying these stock options would be antidilutive to earnings per share. Accordingly, stock options to purchase 5,039,414 shares and 6,566,718 shares at average exercise prices of $50.40 and $48.05 per share, respectively, were excluded from the computation of diluted weighted average shares outstanding for the three months ended December 28, 2007 and December 29, 2006, respectively.

14. SEGMENT INFORMATION

The Company s operations are grouped into two reportable operating segments: Oncology Systems and X-ray Products. These reportable operating segments were determined based on how the Company s Chief Executive Officer, its Chief Operating Decision Maker (CODM), views and evaluates the Company s operations. The Company s Ginzton Technology Center (GTC), SIP business (which includes Bio-Imaging Research, Inc.) and the ACCEL Proton Therapy and Research Instruments business are reflected in the Other category because these operations do not meet the criteria of a reportable operating segment as defined under SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131). The CODM allocates resources to and evaluates the financial performance of each operating segment primarily based on operating earnings.

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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 business segment:

(In millions)	Three Months Ended December 28, 2007	Three Months Ended December 29, 2006
Revenues		
Oncology Systems	$ 361	$ 317
X-ray Products	70	62
Total reportable segments	431	379
Other	28	9
Total company	$ 459	$ 388
Operating Earnings		
Oncology Systems	$ 84	$ 70
X-ray Products	18	15
Total reportable segments	102	85
Other	(3)	(1)
Corporate	(15)	(14)
Total company	$ 84	$ 70

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and

Stockholders of Varian Medical Systems, Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Varian Medical Systems, Inc. and its subsidiaries (the Company) as of December 28, 2007, and the related condensed consolidated statements of earnings for the three-month periods ended December 28, 2007 and December 29, 2006 and the condensed consolidated statement of cash flows for the three-month periods ended December 28, 2007 and December 29, 2006. These interim financial statements are the responsibility of the Company s management.

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

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

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of September 28, 2007, the related consolidated statements of earnings, stockholders equity and cash flows for the year then ended, and the effectiveness of the Company s internal control over financial reporting as of September 28, 2007; and in our report dated November 26, 2007 on financial statements and internal control over financial reporting, we expressed unqualified opinions thereon. The consolidated financial statements are not presented herein. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of September 28, 2007, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP

San Jose, California
February 4, 2008

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

Forward-Looking Statements

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

For the first quarter of fiscal year 2008, revenues were up 18% from the year-ago quarter, net earnings were up 12% and net earnings per diluted share were up 16%. Net orders for the first quarter of fiscal year 2008 were up 21% from the same period last year. Backlog at the end of the first quarter of fiscal year 2008 was up 22% from the end of the first quarter last year. The increases in revenues, net earnings and net orders were driven by growth in our Oncology Systems, X-rays Products and Security and Inspection Products, or SIP, businesses. An increase in tax rate for the first quarter of 2008 compared to the year ago quarter reduced the growth in our net earnings and earnings per diluted share.

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

Oncology Systems international revenues grew significantly in the first quarter of fiscal year 2008 over the year-ago quarter, driven by the continued adoption of IGRT technology. During the same period, North American revenues remained relatively flat. Oncology Systems North American net orders grew modestly in the first quarter of fiscal year 2008 over the same period in fiscal year 2007, during which net orders had a more robust growth rate, and international net orders rose considerably over the year-ago quarter, during which net orders declined significantly. The growth in international net orders reflects the continued adoption of IGRT technology in the region and demand for radiosurgery equipment. The weaker U.S. dollar also favorably impacted the growth in international revenues and net orders.

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

Customers are recognizing IGRT and stereotactic radiosurgery as significant enhancements in curative radiation therapy. We believe treatments using IGRT technology are becoming accepted as a standard of care for radiation therapy and radiosurgery, with North America ahead of international regions in the timing of IGRT adoption. Our net orders growth in the North American and international regions reflects this increased demand for our products that enable IGRT. Over 80% of worldwide orders taken for our high energy and Trilogy linear accelerators during the first quarter of fiscal year 2008 were ordered with our On-Board Imager product, or OBI, which enables IGRT. As of December 28, 2007, we had completed more than 720 installations of OBI on our high-energy and Trilogy accelerators and we have many more in progress.

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We also saw growth in orders for radiosurgery equipment, including orders for 14 Novalis Tx configurations, in the first quarter of fiscal year 2008. Novalis Tx is a combination of our Trilogy Tx linear accelerator, our HD 120 multi-leaf collimator and other VMS and BrainLAB products targeted to neurosurgeons for radiosurgery. Ten of the Novalis Tx configurations were ordered in North America and the remainder were in our international regions.

At the end of December 2007, we received 510(k) clearance from the U.S. Food and Drug Administration for our newly introduced product, RapidArc , which employs a sophisticated algorithm that makes our linear accelerators capable of planning and delivering a complete IMRT treatment in a single revolution of the radiation treatment beam around the patient. We believe RapidArc represents a significant advancement in IMRT cancer treatment and can help drive longer term demand for our linear accelerators and IMRT-related accessory products. We expect North America will adopt this technology first, and then the international regions.

We believe regional fluctuations in demand are consistent with an observed historical pattern where the international regions and North America region have different cycles of demand and technology adoption. We are, however, seeing a faster adoption rate among the early adopters for IGRT technology as compared to IMRT, which may lead to more compressed growth cycles.

Additionally, we are seeing greater length of the customer purchasing cycle for some customers, which we believe results from a more complex decision-making process associated with large dollar value of transactions for more sophisticated IGRT and surgical equipment. Revenues also continued to be influenced by the timing of product shipments in accordance with planned customer-requested delivery dates. These factors may contribute to greater fluctuations in our Oncology Systems net orders and revenue.

Our success in Oncology Systems largely depends upon our ability to retain leadership in technological innovation, the cost effectiveness of our products, the efficacy of our treatment technology and external economic influences. Factors affecting the adoption rate of new technologies such as IGRT and RapidArc could include their more-widely demonstrated efficacy and acceptance of these technologies and our internal efficiency in design, documentation and testing, deployment and installation of our new technologies and products. Additional factors could include customer training on the use of our new technologies or related products and our ability to educate customers about the cost effectiveness of our new technologies and clinical outcome advantages. External economic influences could include hospital financial strength in the United States, foreign currency exchange rates, governmental healthcare policies, significant changes to Medicare and Medicaid reimbursement rates for radiotherapy procedures and government budgeting and tendering cycles.

X-Ray Products. Our X-ray Products business segment manufactures and sells (i) X-ray tubes for use in a range of applications including computed tomography, or CT, scanning, radioscopic/fluoroscopic imaging, mammography, special procedures and industrial applications and (ii) flat panel digital image detectors for filmless X-rays (commonly referred to as flat panel detectors or digital image detectors), which is an alternative to image intensifier tubes for fluoroscopy and X-ray film for radiography. We continue to view the fundamental growth driver for this business to be the on-going success of key original equipment manufacturers, or OEMs, that incorporate our X-ray tube products and flat panel detectors into their medical diagnostic, dental, veterinary and industrial imaging systems. Our flat panel detectors are being incorporated into new filmless X-ray imaging equipment for medical diagnostics, dental imaging, veterinary care and industrial inspection. X-ray Products net orders and revenues grew in the first quarter of fiscal year 2008 over the same period of fiscal year 2007 due primarily to increased demand for our flat panel detectors in the international region.

In December 2007, we acquired Pan-Pacific Enterprises, Inc., or Pan-Pacific, an independent distributor of medical X-ray tubes in China, for approximately $1.9 million, plus an additional contingent earn out payment of up to $3.5 million. Pan-Pacific, which is reported under our X-ray Products segment, enhances the sales channel for X-ray tubes and flat panel products in China.

Our success in our X-ray Products business depends upon our ability to anticipate changes in our markets, the direction of technological innovation and the demands of our customers. Factors affecting the success of our X-ray Products business include our ability to develop products with lower cost, better quality and superior technology and performance, and to maintain strong relationships with our OEM customers.

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Other. The Other category is comprised of SIP (including Bio-Imaging Research, Inc., or BIR, which we acquired in the third quarter of fiscal year 2007), the ACCEL Instruments GmbH, or ACCEL, Proton Therapy and Research Instruments businesses and the operations of the Ginzton Technology Center, or GTC. (Please refer to Note 14 Segment Information of the Notes to the Condensed Consolidated Financial Statements within this Quarterly Report on Form 10-Q.)

SIP designs, manufactures, sells and services Linatron® X-ray accelerators, detectors, imaging processing software and image detection systems for security and inspection purposes, such as cargo screening, border protection and nondestructive examination for a variety of applications. We generally sell SIP products to OEMs who incorporate our products into their inspection systems, which are then sold to customs agencies and other government and military agencies, as well as to commercial private parties in the casting, power, aerospace, chemical, petro-chemical and automotive industries.

We believe growth in the SIP business will be driven by security cargo screening and border protection needs, as well as by the needs of customs agencies to verify shipments for assessing duties and taxes. This business is heavily influenced by U.S. and foreign governmental policies on national and homeland security, border protection and customs revenue activities; reliant on government budgets and appropriations; and subject to political change. We are beginning to see wider deployment of our Linatron X-ray accelerators for cargo screening and border protection as customers are starting to place orders for multiple units. While we are optimistic about SIP s long-term potential and encouraged by the increased interest in our SIP products, use of this technology in security cargo screening and border protection is still in its early stages. Orders and revenues for our SIP products may be unpredictable as governmental agencies may place larger orders with our OEM customers in a short time period and then may not place any orders for a long time period thereafter.

ACCEL supplies proton therapy systems for cancer treatment and scientific research instruments. Our ACCEL Proton Therapy business develops, designs, manufactures and integrates proton therapy systems for the treatment of certain types of cancer. Proton therapy, as a clinical treatment modality, is still in its infancy and the technology is still rapidly developing. We see a high level of interest in the marketplace worldwide for this type of technology, and hope to leverage our experience in traditional radiation therapy to help advance proton therapy, improving clinical utility for existing clinical applications of proton therapy and expanding the use of proton therapy into a broader array of cancer types. We believe that growth in this business will initially develop in the major metropolitan areas in the United States and abroad, and that this market is driven by institutions that wish to expand their clinical offerings and increase their profiles in their respective communities. In order to realize the full potential of the ACCEL business, we need to invest substantial resources to properly commercialize ACCEL s advanced proton technology and to build this new business.

Orders and revenues for our proton therapy products may be unpredictable and fluctuate as a result of a number of factors. Proton therapy facilities are relatively large scale construction projects that take up to three years to construct, and, with the cost of a system in excess of $60 million for a multiple-gantry system and total cost for a center approaching $100 million, will require significant customer investment and perhaps complex project financing. Consequently, the customers decision-making cycle for purchasing a proton therapy project is very long and orders for proton therapy systems generally include many contingencies, which need to be resolved before we book an order. Therefore, we do not expect to book any orders for proton therapy systems in the short term and do not expect to start generating significant proton therapy systems revenues until fiscal year 2010.

The ACCEL research instruments division develops, manufactures and services highly customized components and systems primarily for national research laboratories worldwide for fundamental and applied physics. This market is driven by a few large projects in the billion-dollar range and an increasing number of national accelerator projects ranging from one to five hundred million dollars. Most research projects are publicly funded and decisions on new projects or project upgrades are subject to governmental and political factors. While it appears that there is relatively steady growth in the number and volume of these research projects worldwide, the timing of these research projects may vary significantly. Therefore, orders and revenues for this division may be unpredictable and engineering and manufacturing resources will fluctuate over time as they adapt to the resource requirements of these research projects.

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

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The growth in SIP net orders, which was due to a large order from the U.S. Customs Department for four high-energy X-ray freight inspection systems, together with orders for ACCEL scientific research instrument contracts, contributed to the significant increase in net orders in the Other category in the first quarter of fiscal year 2008 over the year-ago period. Revenues in the Other category grew substantially in the first quarter of fiscal year 2008 over the same period in fiscal year 2007 primarily due to increased revenues of SIP products, while total operating loss increased primarily due to operating loss from ACCEL. As indicated in previous reports, we expect ACCEL to continue to be dilutive to our net earnings per diluted share in fiscal year 2008.

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, as well as the Consolidated Financial Statements and the Notes to the Consolidated Financial Statements and the related Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended September 28, 2007, 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, or GAAP, requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and assumptions are based on historical experience and on various other factors that we believe are reasonable under the circumstances. We periodically review our accounting policies and estimates and make adjustments when facts and circumstances dictate. Our critical accounting policies that are affected by accounting estimates include share-based compensation expense, revenue recognition, valuation of allowance for doubtful accounts, valuation of inventories, assessment of recoverability of goodwill and intangible assets, valuation of warranty obligations, assessment of environmental remediation liabilities, valuation of defined benefit and post-retirement benefit plans and valuation of taxes on earnings. Such accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of our Condensed Consolidated Financial Statements, and actual results could differ materially from these estimates. For a discussion of how these estimates and other factors may affect our business, also refer to the Risk Factors listed under Part II, Item 1A of this Quarterly Report on Form 10-Q.

Share-based Compensation Expense

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

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

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

Revenue Recognition

We frequently enter into sales arrangements with customers that contain multiple elements or deliverables such as hardware, software and services. Judgments as to the allocation of the proceeds received from an arrangement to the multiple elements of the arrangement, the determination of whether any undelivered elements are essential to the functionality of the delivered elements and the appropriate timing of revenue recognition are critical in respect to these arrangements to ensure compliance with GAAP. In addition, the amount of product revenues recognized is affected by our judgments as to whether objective and reliable evidence of fair value exists for hardware products and vendor-specific objective evidence of the fair value for software products in arrangements with multiple elements. Changes to the elements in an arrangement and the ability to establish objective and reliable evidence of fair value or vendor-specific objective evidence of the fair value for those elements could affect the timing of revenue recognition. Revenue recognition also depends on the timing of shipment and is subject to customer acceptance and the readiness of customers facilities. If shipments are not made on scheduled timelines or if the products are not accepted by the customer in a timely manner, our reported revenues may differ materially from expectations. In addition, revenues related to certain highly customized scientific research instrument products and proton therapy commissioning service contracts, as well as highly customized image detection systems are recognized under the percentage of completion method. Under the percentage-of-completion method of accounting, sales and gross profit are recognized as work is performed based on the relationship between actual costs incurred and total estimated costs at the completion of the contract. If a loss is expected on a contract, the estimated loss would be charged to cost of sales in the period the loss is identified. Because the percentage-of-completion method involves considerable use of estimates in determining revenues, costs and profits and in assigning the amounts to accounting periods, and because the estimates must be periodically reviewed and appropriately adjusted, if our estimates prove to be inaccurate or a contract is later terminated, we may be forced to adjust revenues or even record a contract loss in later periods.

Allowance for Doubtful Accounts

Credit evaluations are undertaken for all major sale transactions before shipment is authorized. Normal payment terms usually require payment of a small portion of the total amount due upon signing of the purchase order, a significant amount upon transfer of risk of loss and the remaining amount upon completion of the installation. On a quarterly basis, we evaluate aged items in the accounts receivable aging report and provide an allowance in an amount we deem adequate for doubtful accounts. If our evaluation of our customers financial conditions does not reflect the future ability to collect outstanding receivables, additional provisions may be needed and our operating results could be negatively impacted.

Inventories

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

Goodwill and Intangible Assets

Goodwill is initially recorded when the purchase price paid for a business acquisition exceeds the estimated fair value of the net identified tangible and intangible assets acquired. The majority of companies that we have acquired have not had significant identified tangible assets and, as a result, a significant portion of the purchase price has been typically allocated to intangible assets and goodwill. Our future operating performance will be impacted by the future amortization of these acquired intangible assets and potential impairment charges related to goodwill if indicators of impairment exist. As a result of business acquisitions, the allocation of the purchase price to goodwill and intangible assets could have a significant impact on our future operating results. The allocation of the purchase price of the acquired companies to goodwill and intangible assets requires us to make significant estimates and assumptions, including estimates of future cash flows expected to be

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generated by the acquired assets and the appropriate discount rate for these cash flows. Should conditions be different from management s estimates at the time of the acquisition, material write-downs of intangible assets and/or goodwill may be required, which would adversely affect our operating results.

We evaluate goodwill and purchased assets with indefinite lives for impairment annually in accordance with SFAS 142 *Goodwill and Other Intangible Assets*. The impairment test for goodwill is a two-step process. Step one consists of a comparison of the fair value of a reporting unit with its carrying amount, including the goodwill allocated to each reporting unit. We determine the fair value of our reporting units based on the present value of estimated future cash flows of the reporting units. If the carrying amount is in excess of the fair value, step two requires the comparison of the implied fair value of the reporting unit with the carrying amount of the reporting unit s goodwill. Any excess of the carrying value of the reporting unit s goodwill over the implied fair value of the reporting unit s goodwill is recorded as an impairment loss. The impairment test for intangible assets with indefinite useful lives, if any, consists of a comparison of fair value to carrying value, with any excess of carrying value over fair value being recorded as an impairment loss. We will continue to make assessments of impairment on an annual basis in the fourth quarter of our fiscal years or more frequently if indicators of potential impairment arise. In the fourth quarter of fiscal year 2007, we performed goodwill impairment testing for the four reporting units that carried goodwill, Oncology Systems, X-ray Products, ACCEL and SIP, and found no impairment.

Warranty Obligations

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

Environmental Matters

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

Defined Benefit and Post-Retirement Benefit Plans

We sponsor six defined benefit pension plans in Germany, Japan, Switzerland and the United Kingdom covering the employees who meet the applicable eligibility requirements. In July 2007, we made changes to the defined benefit plan in the United Kingdom by terminating the accrual of additional benefits for existing participants and suspending the enrollment of new participants. We also sponsor a post-retirement benefit plan that provides healthcare benefits to certain eligible retirees in the United States. We do not have any defined benefit pension plans in the United States. Several statistical and other factors that attempt to anticipate future events are used in calculating the expense and liability related to those plans for which the benefit is actuarially determined. These factors include assumptions about the discount rate, expected return on plan assets, rate of future compensation increases and healthcare cost increases, which we determine within certain guidelines. In addition, we also use subjective factors, such as withdrawal and mortality rates, to calculate the expense and liability. The actuarial assumptions we use are long-term assumptions and may differ materially from actual experience particularly in the short term due to changing market and economic conditions and changing participant demographics. These differences may have a significant impact on the amount of pension expense we 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 of those assets. The discount rate enables us to state expected future cash flows at a present value on the measurement date. The discount rates used for defined benefit plans in all countries are based on high

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quality AA-rated corporate bonds with durations corresponding to the expected durations of the benefit obligations. In countries where the corporate bond market is not sufficiently representative at longer durations, the discount rate also takes into account the yield of long-term government bonds corresponding to the duration of the benefit obligations and the difference between the yield curve on high quality corporate fixed-income investments and government fixed-income investment. A lower discount rate increases the present value of benefit obligations.

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 evaluating our tax positions and determining our provision for taxes on earnings.

Effective as of the beginning of the first quarter of fiscal year 2008, we adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*, or FIN 48. FIN 48 contains a two-step approach to recognizing, derecognizing, and measuring uncertain tax positions accounted for in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. 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 to include interest and penalties related to unrecognized tax benefits within the provision for taxes on earnings did not change as a result of the adoption of FIN 48.

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

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

Results of Operations

Fiscal Year

Our fiscal year is the 52- or 53-week period ending on the Friday nearest September 30. Fiscal year 2008 is the 52-week period ending September 26, 2008, and fiscal year 2007 was the 52-week period ended September 28, 2007. The fiscal quarters ended December 28, 2007 and December 29, 2006 were both 13-week periods.

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Discussion of Financial Data for the First Quarter of Fiscal Year 2008 Compared to the First Quarter of Fiscal Year 2007

Total Revenues

Revenues by sales classification (Dollars in millions)	Three Months Ended December 28, 2007	December 29, 2006	Percent Change
Product	$ 364.3	$ 317.8	15%
Service Contracts and Other	94.2	70.1	35%
Total Revenues	$ 458.5	$ 387.9	18%
Product as a percentage of total revenues	*79%*	*82%*	
Service Contracts and Other as a percentage of total revenues	*21%*	*18%*	
Revenues by region			
North America	$ 201.7	$ 196.1	3%
Europe	155.2	121.5	28%
Asia	86.9	58.8	48%
Rest of world	14.7	11.5	29%
Total International (1)	256.8	191.8	34%
Total	$ 458.5	$ 387.9	18%
North America as a percentage of total revenues	*44%*	*51%*	
International as a percentage of total revenues	*56%*	*49%*	

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

For the first quarter of fiscal year 2008, total revenues increased by 18% over total revenues for the first quarter of fiscal year 2007 due to increases in both business segments, as well as contribution from the Other category, which in the first quarter of fiscal year 2008 included the previously acquired businesses of ACCEL and BIR.

The increase in total product revenues in the first quarter of fiscal year 2008 over the year-ago quarter was driven by the increase in product revenues in both business segments and our Other businesses. Oncology Systems and our Other businesses contributed to the growth in service contracts and other revenues in the first quarter of fiscal year 2008 over the same period in fiscal year 2007, which represented a higher percentage of total revenues than in the year-ago period. Service contract revenues grew at a higher rate than product revenues primarily due to the increase in Oncology Systems service contract revenues, as well as contributions from ACCEL.

Oncology Systems was the primary contributor to the increase in international revenues for the first quarter of fiscal year 2008, although revenue growth in X-ray Products and the Other businesses, as well as the weaker U.S. dollar, also contributed. North American revenue growth was primarily due to growth in both business segments and our Other businesses.

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Oncology Systems Revenues

Revenues by sales classification (Dollars in millions)	Three Months Ended December 28, 2007	December 29, 2006	Percent Change
Product	$ 276.6	$ 248.4	11%
Service Contracts (1)	83.7	68.1	23%
Total Oncology Systems revenues	$ 360.3	$ 316.5	14%
Product as a percentage of total Oncology Systems revenues	*77%*	*78%*	
Service Contracts as a percentage of total Oncology Systems revenues	*23%*	*22%*	
Oncology Systems revenues as a percentage of total revenues	*79%*	*82%*	

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

The increase in Oncology Systems product revenues in the first quarter of fiscal year 2008 over the same period in the prior year was primarily due to higher revenues of our high energy linear accelerators, our Trilogy linear accelerator, and accessory products that enable IGRT (including our OBI), which was driven by the continued adoption of IGRT technology. This increase was partially offset by a decrease in revenues of IMRT-upgrades. As noted in previous reports, we saw a slowdown in demand for IMRT-related products after several years of rapid adoption of IMRT technology. The increase in service contracts revenues in the first quarter of fiscal year 2008 from the same period in fiscal year 2007 was primarily driven by the increase in sophistication of our products and the growing installed base of software products that generate increased annual maintenance contracts and renewals.

Revenues by region (Dollars in millions)	Three Months Ended December 28, 2007	December 29, 2006	Percent Change
North America	$ 167.2	$ 165.1	1%
Europe	128.2	108.2	19%
Asia	52.2	33.4	56%
Rest of world	12.7	9.8	30%
Total International	193.1	151.4	28%
Total Oncology Systems Revenues	$ 360.3	$ 316.5	14%
North America as a percentage of Oncology Systems revenues	*46%*	*52%*	
International as a percentage of Oncology Systems revenues	*54%*	*48%*	

The growth in international revenues was primarily due to an increase in product revenues of our high energy linear accelerators and accessory products that enable IGRT (including our OBI) in all international regions and, to a lesser extent, an increase in service contracts revenues primarily in Europe. This increase was partially offset by a decrease in product revenues of IMRT-upgrades primarily in Europe, reflecting a slowdown in demand for IMRT-related products after several years of rapid adoption of IMRT technology.

North American revenues remained relatively flat in the first quarter of fiscal year 2008 compared to the year-ago quarter. The increase in product revenues of our Trilogy linear accelerator and service contracts revenues were significantly offset by the declines in product revenues of high energy linear accelerators and IMRT-upgrades in North America.

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

Systems revenues also continued to be influenced by the timing of product shipments in accordance with planned customer-requested delivery dates.

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X-ray Products Revenues

Revenues by region (Dollars in millions)	Three Months Ended December 28, 2007	December 29, 2006	Percent Change
North America	$ 27.2	$ 26.8	2%
Europe	9.7	8.6	14%
Asia	31.2	25.3	23%
Rest of world	2.0	1.7	18%
Total International	42.9	35.6	21%
Total X-ray Products Revenues	$ 70.1	$ 62.4	12%
North America as a percentage of X-ray Products revenues	*39%*	*43%*	
International as a percentage of X-ray Products revenues	*61%*	*57%*	
X-ray Products revenues as a percentage of total revenues	*15%*	*16%*	

International X-ray Products revenue growth in the first quarter of fiscal year 2008 over the same period in fiscal year 2007 was primarily due to increased revenues of our high power, anode grounded CT scanning tubes and increased revenues for our flat panel detectors, primarily to OEM customers in Asia. The modest growth in X-ray Products revenues in North America in the first quarter of fiscal year 2008 over the year-ago period was driven by higher revenues of our flat panel detectors to our OEM customers.

Other Revenues

Revenues by sales classification (Dollars in millions)	Three Months Ended December 28, 2007	December 29, 2006	Percent Change
Product	$ 17.6	$ 7.1	149%
Service Contracts and Other	10.5	1.9	440%
Total Other revenues	$ 28.1	$ 9.0	211%
Other revenues as a percentage of total revenues	*6%*	*2%*	

For our Other category, comprised of SIP (including BIR), ACCEL and GTC, revenues in the first quarter of fiscal year 2008 increased over the year-ago period primarily due to growth in product and service revenues in our SIP business as well as contributions from ACCEL Research Instruments, which we acquired in the second quarter of fiscal year 2007. The revenue growth in our SIP business was driven by the higher product revenues of our Linatron products to our OEM customers for cargo screening and border protection.

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Gross Margin

(Dollars in millions)	Three Months Ended December 28, 2007	December 29, 2006	Percent Change
Dollar by segment			
Oncology Systems	$ 154.5	$ 131.9	17%
X-ray Products	27.7	25.5	9%
Other	8.6	2.8	206%
Gross margin	$ 190.8	$ 160.2	19%
Percentage by segment			
Oncology Systems	*42.9%*	*41.7%*	
X-ray Products	*39.5%*	*40.8%*	
Total Company	*41.6%*	*41.3%*	

Total gross margin improved by 0.3 percentage points in the first quarter of fiscal year 2008 compared to the same period in fiscal year 2007 due to an increase in Oncology Systems gross margin that was partially offset by a decrease in X-ray Products gross margin compared to the year-ago period.

Oncology Systems gross margin increased by 1.2 percentage points in the first quarter of fiscal year 2008 compared to the first quarter of 2007 primarily due to an increase in product gross margin to 41.0% in the first quarter of fiscal year 2008 from 40.0% in the first quarter of fiscal year 2007, as well as an increase in service contracts gross margin to 49.2% in the first quarter of fiscal year 2008 from 47.9% in the same period in fiscal year 2007. The improvement in product gross margin was primarily due to higher sales volume and product mix shift toward sales of higher margin Oncology Systems products in North America, which was partially offset by the geographic mix shift towards a higher proportion of international revenues, which typically have lower margins than revenues from North America. The improvement in service contracts gross margin was due primarily to higher contract volumes and growth in higher margin software maintenance contracts in Oncology Systems.

X-ray Products gross margin in the first quarter of fiscal year 2008 decreased by 1.3 percentage points from the first quarter of fiscal year 2007. The decline in gross margin primarily resulted from product mix shift toward sales of lower margin X-ray tube products and increased material costs for X-ray tube products. X-ray Products gross margin will continue to be impacted by factors such as sales mix between flat panel detectors and X-ray tube products, product pricing, timing of new product introduction, cost reduction efforts and material costs.

Research and Development

(Dollars in millions)	Three Months Ended December 28, 2007	December 29, 2006	Percent Change
Research and development	$ 29.0	$ 27.0	8%
As a percentage of total revenues	*6%*	*7%*	

For the first quarter of fiscal year 2008, research and development expense grew at a lower rate than revenues. The $2.0 million increase in research and development expense for the first quarter of fiscal year 2008 was primarily driven by increased spending of $1.8 million in Oncology Systems, which was attributable primarily to an increase in employee headcount, material costs and consulting expenses for the development of our next generation linear accelerator products.

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Selling, General and Administrative

(Dollars in millions)	Three Months Ended December 28, 2007	December 29, 2006	Percent Change
Selling, general and administrative	$ 77.5	$ 63.1	23%
As a percentage of total revenues	*17%*	*16%*	

The $14.4 million increase in selling, general and administrative expenses for the first quarter of fiscal year 2008 compared to the same period in fiscal year 2007 was primarily attributable to: (a) operating expenses of $6.3 million associated with ACCEL and BIR, which we acquired in the second quarter and third quarter of last fiscal year, respectively, (b) increased expenses of $2.6 million associated with growth in our Oncology Systems revenues that were primarily related to certain commission arrangements, (c) a loss of $0.2 million in the first quarter of fiscal year 2008, compared to a gain of $1.2 million in the year-ago period, for hedging balance sheet exposures from our various foreign subsidiaries and business units, (d) unfavorable foreign currency translation impact of $1.4 million resulting from the relatively weak U.S. dollar for our foreign operations as the selling, general and administrative expenses are translated into U.S. dollars, (e) increased legal fees of $1.1 million and (f) a loss recognized for the equity investment in dpiX Holding of $1.0 million (please refer to Note 4 Related Party Transactions in Notes to the Condensed Consolidated Financial Statements).

Interest Income, Net

(Dollars in millions)	Three Months Ended December 28, 2007	December 29, 2006	Percent Change
Interest income, net	$ 1.5	$ 2.4	(38%)

The decrease in interest income, net in the first quarter of fiscal year 2008 compared to the same period in fiscal year 2007 was attributable to lower balances of cash, cash equivalents and marketable securities and increased borrowings in the first quarter of fiscal year 2008.

Taxes on Earnings

	Three Months Ended December 28, 2007	December 29, 2006	Change
Effective tax rate	35.4%	31.7%	3.7%

The increase in our effective tax rate in the first quarter of fiscal year 2008 from the same period in fiscal year 2007 was primarily due to: (i) our adoption of FIN 48 in the quarter and the application of the principles and methodologies of FIN 48 to our current period activity, including the recognition of interest expense and penalties, classified as tax expense, for tax positions taken relative to the current and prior periods, which resulted in an addition to the liability for uncertain tax positions, and (ii) a tax benefit in the year-ago period associated with the retrospective reinstatement of the federal research and development tax credit, which had previously expired on December 31, 2005.

In general, our effective income tax rate differs from the U.S. federal statutory rate primarily because our foreign earnings are taxed at rates that are, on average, lower than the U.S. federal rate, and our domestic earnings are subject to state income taxes. Our future effective tax rate could be adversely affected by having lower earnings than anticipated in countries where we have lower statutory rates and higher earnings than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets or liabilities, and changes in tax laws or interpretations of those laws. We also expect that our effective tax rate may experience increased fluctuation from period to period under the provisions of FIN 48. Please refer to the further discussion of the adoption of FIN 48 in Note 10 Income Taxes of the Notes to the Condensed Consolidated Financial Statements.

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Net Earnings Per Diluted Share

	Three Months Ended		
	December 29, 2007	December 29, 2006	Percent Change
Net earnings per diluted share	$ 0.43	$ 0.37	16%

The increase in earnings per diluted share in the first quarter of fiscal year 2008 over the first quarter of fiscal year 2007 resulted from the increase in total revenues and the reduction in outstanding shares of common stock due to stock repurchases, partially offset by an increase in our effective tax rate.

Net Orders

Total Net Orders (by segment and region)	Three Months Ended		
(Dollars in millions)	December 28, 2007	December 29, 2006	Percent Change
Oncology Systems:			
North America	$ 207.2	$ 192.8	7%
Total International	178.5	137.4	30%
Total Oncology Systems	$ 385.7	$ 330.2	17%
X-ray Products:			
North America	$ 25.9	$ 31.2	-17%
Total International	49.2	36.3	35%
Total X-ray Products	$ 75.1	$ 67.5	11%
Other:	$ 32.7	$ 10.2	220%
Total Net Orders:	$ 493.5	$ 407.9	21%

The increase in our net orders in the first quarter of fiscal year 2008 over the year-ago period was due to growth in both of our business segments and the Other businesses, including contributions from ACCEL and BIR, which we acquired in the second quarter and third quarter of fiscal year 2007, respectively. The weaker U.S. dollar in the first quarter of fiscal year 2008 over the year-ago period also favorably impacted the growth in our international net orders.

The growth in Oncology Systems North American net orders in the first quarter of fiscal year 2008 over the year-ago period was primarily driven by demand for Novalis Tx and increased demand for high energy linear accelerators and our software products for treatment planning and information management.

The growth in international net orders in the first quarter of fiscal year 2008 over the first quarter of fiscal year 2007 reflects demand for Novalis Tx, and increased demand for our high energy linear accelerators, our accessory products that enable IGRT (including our OBI) as well as an increase in orders in our service business. All geographic regions contributed to the increase in international net orders in the first quarter of fiscal year 2008. We expect that IGRT will continue to be one of the main contributors to net orders and revenue in our Oncology Systems business segment and believe that Novalis Tx will also contribute to this growth. We also expect that RapidArc will contribute to the long-term growth in Oncology Systems net orders and revenues.

For the trailing twelve months Oncology Systems net order growth rate as of December 28, 2007 was 10%, including a 3% increase for North America and a 19% increase for international regions. By comparison, the trailing twelve months Oncology Systems net order growth rate as of September 28, 2007 was 7%, including a 5% increase for North America and a 9% increase for international regions. The trailing twelve months Oncology Systems net order growth rate as of June 29, 2007 was 7%, including a 12% increase for North America and a 1% increase for international regions. Consistent with the historical pattern, we expect that Oncology Systems net orders will continue to experience regional

fluctuations.

X-ray Products have relatively short cycle from net orders to shipments. The increase in X-ray Products net orders in the first quarter of fiscal year 2008 over the year-ago period was primarily due to increased demand for our flat panel detectors. The flat panel detector product line has become a significant contributor to our X-ray Products business segment, and we believe this product line will continue to contribute to our growth in net orders as flat panel detectors, which enable filmless X-ray imaging, replace traditional film and image-intensifier X-ray products in many medical applications.

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The Other category, comprised of SIP (including BIR), ACCEL and GTC, experienced strong net orders growth in the first quarter fiscal year 2008 over the same period in fiscal year 2007. The growth in net orders in the Other category was due to (i) orders received for high-energy X-ray freight inspection systems and (ii) new net orders received for ACCEL s scientific research instruments.

We are beginning to see wider deployment of our Linatron X-ray accelerators for cargo screening and border protection are optimistic about the long-term potential of our SIP business. However, orders for our SIP products may be unpredictable as governmental agencies may place large orders in a short time period and then may not place any orders for a long time thereafter.

Also, while we believe there is a promising market for proton therapy systems, the market for proton therapy treatment is still developing, and we expect great variability in the demand for these products due to the large scale of the related construction projects, the complexity of project financing and the resulting longer customer decision cycles when compared with our Oncology Systems business. We do not expect to book an order for proton therapy system in the short term. We also expect that demand for ACCEL research instruments products will vary as they are tied primarily to large, national research laboratory projects.

In any given period, orders growth in either North America or international regions, or both, could fluctuate, because of the high dollar amount of individual orders, particularly in businesses other than X-ray Products. The timing of sales and 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 although the sales and revenue recognition cycles are usually shorter for some types of orders, such as upgrades (*i.e.,* the addition of new features or accessories to existing equipment). Thus, orders in any quarter or period may not be directly correlated to the level of sales or revenues in any particular future quarter or period. Moreover, as the overall mix of net orders includes a greater proportion of software products and newly introduced Oncology Systems products, which typically take more time from order to completion of installation and acceptance, the average time period within which orders convert into sales could lengthen and our revenue in a specific period could be lower as a result.

Backlog

At December 28, 2007, we had a backlog of $1.7 billion, an increase of 22% compared to December 29, 2006. Our Oncology Systems backlog at December 28, 2007 increased by 16% from December 29, 2006, including a 20% increase for North America and an 8% increase for the international regions.

Liquidity and Capital Resources

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

Cash and Cash Equivalents

The following table summarizes our cash and cash equivalents:

(In millions)	December 28, 2007	September 28, 2007	Increase/ (Decrease)
Cash and cash equivalents	$ 334	$ 263	$ 71

Our cash and cash equivalents increased $71 million from $263 million at September 28, 2007 to $334 million at December 28, 2007. The increase in cash and cash equivalents in the first quarter of fiscal year 2008 was primarily due to $121 million of cash generated from operating activities, $24 million of cash provided by stock option exercises and $11 million of cash provided by the excess tax benefits from share-based compensation. These increases were partially offset by cash used for the repurchase of $41 million in common stock, net repayment of $23 million under the credit facility and capital expenditures of $17 million.

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At December 28, 2007, we had approximately $22 million or 7% of total cash and cash equivalents in the United States. Approximately $312 million or 93% of total cash and cash equivalents was held abroad and could be subject to additional taxation if it were repatriated to the United States. As of December 28, 2007, most of our cash and cash equivalents that were held abroad were in U.S. dollars. Because our cash levels in the United States are relatively low, we have used our credit facility to meet our cash needs from time to time and may do so in the future.

Cash Flows

	Three Months Ended	
(In millions)	**December 28, 2007**	**December 29, 2006**
Net cash flow provided by (used in):		
Operating activities	$ 121	$ 83
Investing activities	(18)	(28)
Financing activities	(29)	(59)
Effects of exchange rate changes on cash and cash equivalents	(3)	(4)
Net increase (decrease) in cash and cash equivalents	$ 71	$ (8)

Our primary cash inflows and outflows for the first quarter of fiscal years 2008, as compared to the first quarter of fiscal year 2007, were as follows:

In the first quarter of fiscal year 2008, we generated net cash from operating activities of $121 million, compared to $83 million for the first quarter of fiscal year 2007.

The $38 million increase in net cash from operating activities during the first quarter of fiscal year 2008 compared to the year-ago period was driven by a net change of $32 million in operating assets and liabilities (working capital items) and an increase of $6 million in net earnings.

The major contributors to the net change in working capital items in the first quarter of fiscal year 2008 were accounts receivable, inventories, prepaid expenses and other current assets, deferred revenues and accrued expenses as follows:

Accounts receivables decreased by $74 million due to strong collection performance in the first quarter of fiscal year 2008 and the timing of product deliveries in the fourth quarter of fiscal year 2007.

Inventories increased by $25 million due to anticipated customer demands for products in all of our businesses during fiscal year 2008.

Prepaid expenses and other current assets increased by $10 million primarily due to an increase in miscellaneous receivables.

Deferred revenues increased by $23 million primarily due to timing of revenue recognized based on customer acceptance of our Oncology Systems products.

Accrued expenses decreased by $12 million primarily due to a decrease in income taxes payable. The decrease in income taxes payable was the result of estimated tax payments made during the first quarter of fiscal year 2008.

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

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Investing activities used net cash of $18 million in the first quarter of fiscal year 2008, compared to $28 million used in the first quarter of fiscal year 2007. Cash used for purchases of property, plant and equipment was $17 million for the first quarter of fiscal year 2008, compared to $12 million for the same period in fiscal year 2007. In the first quarter of fiscal year 2007, we invested $5 million in dpiX Holding for the construction of a manufacturing facility in Colorado and used $5 million in net purchases of marketable securities.

Financing activities used net cash of $29 million in the first quarter of fiscal year 2008 compared to $59 million in the first quarter of fiscal year 2007. During the first quarter of fiscal year 2008, we used $41 million to repurchase shares of our common stock and $23 million for net repayments under our credit facility, which were partially offset by $24 million received from employee stock option exercises and $11 million in excess tax benefits from share-based compensation. In the first quarter of fiscal year 2007, we used $77 million to repurchase our shares and received $10 million from employee stock option exercises and $8 million in excess tax benefits from share-based compensation.

We expect our capital expenditures, which typically represent construction and/or purchases of facilities, manufacturing equipment, office equipment and furniture and fixtures, as well as capitalized costs related to the implementation of software applications, will be approximately 4.5% of revenues in fiscal year 2008.

We have a $100 million unsecured revolving credit facility with Bank of America, N.A., or BofA, to support general corporate purposes, including working capital requirements, capital expenditures, permitted acquisitions and other lawful corporate purposes. Borrowings under the credit facility accrue interest either (i) based on the London InterBank Offered Rate, or LIBOR, plus a margin of .45% to .70% based on a leverage ratio involving funded indebtedness and earnings before interest, tax and depreciation and amortization, or EBITDA, or (ii) based upon a base rate of either the federal funds rate plus .5% or BofA s announced prime rate, whichever is greater, plus a margin of 1.75% to 2.25% based on a leverage ratio involving funded indebtedness and EBITDA, depending upon our instructions to BofA. We may select borrowing periods of one, two, three or six months for advances based on the LIBOR rate. Interest rates on advances based on the base rate are adjustable daily. As of December 28, 2007, $18 million was outstanding under this line of credit with a weighted average interest rate of 5.70%. This credit facility contains customary affirmative and negative covenants for facilities of this type. We have also agreed to maintain certain financial covenants relating to (i) leverage ratios involving funded indebtedness and EBITDA (earnings before interest, tax and depreciation and amortization), (ii) liquidity and (iii) consolidated assets. As of December 28, 2007, we were in compliance with all covenants. For further discussion regarding this credit facility, please refer to Note 6 Line of Credit of the Notes to the Condensed Consolidated Financial Statements.

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 through fiscal year 2008. We currently anticipate that we will continue to utilize our available liquidity and cash flows from operations, as well as borrowed funds, to repurchase our common stock, make strategic acquisitions, invest in the growth of our business and invest in our systems and processes.

Total debt as a percentage of total capital decreased to 7.2% at December 28, 2007 compared to 9.9% at September 28, 2007 largely due to the repayment of the credit facility during the first quarter of fiscal year 2008. The ratio of current assets to current liabilities increased to 1.67 to 1 at December 28, 2007 from 1.48 to 1 at September 28, 2007 primarily due to increased cash and cash equivalents and the reclassification of unrecognized tax benefits from accrued expenses to other long-term liabilities upon the adoption of FIN 48.

Days Sales Outstanding

Trade accounts receivable days sales outstanding, or DSO, were 87 days at December 28, 2007 compared to 93 days at December 29, 2006. Our accounts receivable and DSO are primarily impacted by timing of product shipments, collections performance, payment terms and mix of revenues from different regions.

Stock Repurchase Program

On July 24, 2007, our Board of Directors approved the repurchase of up to 12,000,000 shares of our common stock during the period beginning on July 30, 2007 through December 31, 2008**.** During the three months ended December 28, 2007, we paid $41 million to repurchase 920,000 shares of VMS common stock. All shares that have been repurchased have been retired. As of December 28, 2007, we could repurchase up to an additional 10,080,000 shares of our common stock.

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Contractual Obligations

As a result of the adoption of FIN 48, we reclassified unrecognized tax benefits to long-term income taxes payable, which is included in Other long-term liabilities. Long-term income taxes payable includes the liability for uncertain tax positions, including interest and penalties, and may also include other long-term tax liabilities. As of December 28, 2007, our liability for uncertain tax positions was $92.6 million and we do not expect to settle or make payments of these amounts in the next twelve months. 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.

Except for the item discussed above and the change in the outstanding balance in credit facility, there has been no significant change to the other contractual obligations we reported in our Annual Report on Form 10-K for fiscal year 2007.

Contingencies

Environmental Remediation Liabilities

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

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

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

As described below, we have accrued a total of $14.9 million as of December 28, 2007 to cover our liabilities for these cleanup projects.

Various uncertainties make it difficult to estimate the likelihood or cost of project management costs, legal costs and the costs of certain third-party claims at all of the sites and facilities. In addition, for the nine sites and one of the facilities, various uncertainties make it difficult to assess the likelihood and scope of further cleanup activities or to estimate the future costs of such activities. As of December 28, 2007, we nonetheless estimated that our future exposure (net of VI s and VSEA s indemnification obligations) for the cleanup costs for these ten locations, as well as project management costs, legal costs and the costs of certain third-party claims for all locations ranged in the aggregate from $3.3 million to $7.5 million. We believe that no amount in the foregoing range of estimated future costs is more probable of being incurred than any other amount in such range and therefore we have accrued $3.3 million for these cleanup projects as of December 28, 2007. The amount accrued has not been discounted to present value due to the uncertainties that make it difficult to develop a best estimate of future costs.

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As to all other facilities, we have gained sufficient knowledge to better estimate the scope and costs of future cleanup activities based upon formal agreements with other parties defining our future liabilities or formal cleanup plans that have either been approved by or completed in accordance with the requirements of the state or federal environmental agency with jurisdiction over the facility. As of December 28, 2007, we estimated that our future exposure (net of VI s and VSEA s indemnification obligations) for the cleanup costs at these facilities, and reimbursements of third-party s claims for these facilities, ranged in the aggregate from $8.5 million to $36.6 million. The time frames over which these cleanup project costs are estimated vary with each facility, ranging from 2 years to 30 years as of December 28, 2007. As to each of these facilities, management determined that a particular amount within the range of estimated costs was a better estimate of the future environmental liability than any other amount within the range, and that the amount and timing of these future costs were reliably determinable. The best estimate within the range was $16.6 million at December 28, 2007. We accordingly accrued $11.6 million, which represents our best estimate of the future costs of $16.6 million discounted at 4%, net of inflation. This accrual is in addition to the $3.3 million described in the preceding paragraph.

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

We receive certain cash payments in the form of settlements and judgments from defendants, our insurers and other third parties from time to time. We have also reached an agreement with an insurance company under which the insurance company has agreed to pay a portion of our past and future environmental-related expenditures, and we, therefore, had included a $2.9 million receivable in Other assets at December 28, 2007. We believe that this receivable is recoverable because it is based on a binding, written settlement agreement with a solvent and financially viable insurance company and the insurance company has paid the claims that we have made in the past.

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

Acquisition-Related Commitments/Obligations

When we acquired ACCEL in January 2007, ACCEL was involved in a contract-related lawsuit. Subsequent to the acquisition, we settled this lawsuit and agreed to perform under a new contract for a fixed price. From January to September 2007, we gathered information related to the expected cost of satisfying our contract commitment and completed our assessment as of September 28, 2007. As a result, the final purchase price allocation of ACCEL included a loss accrual related to this contingency of 28.3 million, or approximately $40 million. If the actual costs related to the contingency exceed the estimated amount or if the estimated loss increases, the variances will be recognized in the Consolidated Statement of Earnings in the periods these variances arise. As of December 28, 2007, the actual costs incurred were consistent with the estimated costs for the contract.

Other Proceedings

We are involved, from time to time, in legal proceedings, claims and government inspections or investigations, arising in the ordinary course of our business. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. We accrue amounts that we believe are adequate to address any liabilities related to legal proceedings and other loss contingencies that we believe will result in a probable loss. While there can be no assurances as to the ultimate outcome of any legal proceeding or other loss contingency involving us, management does not believe any pending matter will be resolved in a manner that would have a material adverse effect on our consolidated financial position, results of operations or cash flows. However, it is possible that a legal or other proceeding brought against us could have an impact of this nature.

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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 term of these indemnification arrangements is generally perpetual. Except for losses related to property damages, the maximum potential amount of future payments we could be required to make under these agreements is unlimited. As of December 28, 2007, we have not incurred any significant costs since the spin-offs to defend lawsuits or settle claims related to these indemnification arrangements.

We have entered into indemnification agreements with our directors and officers that may require us to indemnify our directors and officers against liabilities that may arise by reason of their status or service as directors or officers, and to advance their expenses incurred as a result of any legal proceeding against them as to which they could be indemnified. Generally, the maximum obligation under such indemnifications is not explicitly stated and, as a result, the overall amount of these obligations cannot be reasonably estimated.

Recent Accounting Pronouncements

In September 2006, FASB, issued SFAS, No. 157, *Fair Value Measurements*, or SFAS 157. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 will be effective for us beginning in the first quarter of fiscal year 2009. We are currently assessing the impact that SFAS 157 may have on our consolidated financial position, results of operations and cash flows.

In September 2006, the FASB issued SFAS No. 158, *Employer s Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R),* or SFAS 158. SFAS 158 requires us to (a) recognize a plan s funded status in our statement of financial position, (b) measure a plan s assets and the obligations that determine our funded status as of the end of our fiscal year and (c) recognize changes in the funded status of a defined benefit plan in the year in which the changes occur through other comprehensive income. We adopted the requirement to recognize the funded status of a defined benefit plan and the disclosure requirements in the fourth quarter of fiscal year 2007. Please refer to Note 10 Retirement Plans in the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended September 28, 2007 for a discussion of the effects of adopting the recognition provisions and disclosure requirements of SFAS 158. We are not required to adopt the measurement date provisions until fiscal year 2009. We are assessing the potential impact, if any, that the measurement date provision of SFAS 158 may have on our consolidated financial position, results of operations or cash flows. Based on the evaluation to date, we do not believe the adoption of the measurement date provisions of SFAS 158 will have a material impact on our financial statements.

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

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations,* or SFAS 141R. SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in our financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective for us in the first quarter of fiscal year 2010. We are currently assessing the potential impact, if any, of the adoption of SFAS 141R on our consolidated financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51,* or SFAS 160. SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent s, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent s ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective for us in the first quarter of fiscal year 2010. We are currently evaluating the potential impact, if any, of the adoption of SFAS 160 on our consolidated financial position, results of operations and cash flows.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Foreign Currency Exchange Rate Risk

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

We have many transactions denominated in foreign currencies and address certain of those financial exposures through a program of risk management that includes the use of derivative financial instruments. We sell products throughout the world, often in the currency of the customer s country, and typically hedge certain of these larger firmly committed foreign currency denominated sales orders when they are not in the subsidiaries functional currency. These foreign currency sales orders that fit our risk management policy criteria, excluding the amounts relating to the products made outside of the United States, are hedged with forward contracts. We may use other derivative instruments in the future. We enter into foreign currency forward contracts primarily to reduce the effects of fluctuating foreign currency exchange rates. We do not enter into forward contracts for speculative or trading purposes. The forward contracts range from one to twelve months in maturity. As of December 28, 2007, we did not have any forward contracts with an original maturity greater than twelve months. As international deliveries may extend beyond twelve months, we may hedge beyond twelve months in the future.

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

The notional value of sold forward contracts for both hedges of foreign currency denominated sales orders and balance sheet exposures from our subsidiaries outstanding as of December 28, 2007 totaled $462.2 million. The notional value of purchased forward contracts for both hedges of foreign currency denominated sales orders and balance sheet exposures from our subsidiaries outstanding as of December 28, 2007 totaled $44.0 million. The notional amounts of forward contracts are not a measure of our exposure. The fair value of forward contracts generally reflects the estimated amounts that we would receive or pay to terminate the contracts at the reporting date, thereby taking into account and approximating the current unrealized and realized gains or losses of the open contracts. A move in foreign currency exchange rates would change the fair value of the contracts, and the fair value of the underlying exposures hedged by the contracts would change in a similar offsetting manner.

Interest Rate Risk

Our market risk exposure to changes in interest rates depends primarily on our investment portfolio and short-term borrowings. Our investment portfolio consists of cash and cash equivalents as of December 28, 2007. We did not have any marketable securities at December 28, 2007. The principal amount of cash and cash equivalents at December 28, 2007 totaled $334 million with a weighted average interest rate of 3.55%. In the event that interest rates were to decrease substantially, we might reinvest a substantial portion of our investment portfolio at lower interest rates.

We have established a $100 million unsecured revolving credit facility with BofA to support general corporate purposes, including working capital requirements, capital expenditures, permitted acquisitions and other lawful corporate purpose. Borrowings under the credit facility accrue interest either (i) based on the LIBOR plus a margin of .45% to .70% based on a leverage ratio involving funded indebtedness and EBITDA or (ii) based upon a base rate of either the federal funds rate plus .5% or BofA s announced prime rate, whichever is greater, plus a margin of 1.75% to 2.25% based on a leverage ratio involving funded indebtedness and EBITDA, depending upon our instructions to BofA. We may select borrowing periods of one, two, three or six months for advances based on the LIBOR rate. Interest rates on advances based on the base rate are adjustable daily. We are affected by market risk exposure primarily through the effect of changes in interest rates on amounts payable under this credit facility. As of December 28, 2007, $18 million in aggregate principal amount was outstanding under the credit facility with interest being accrued based on a margin plus LIBOR. If the principal amounts outstanding under this credit facility remained at this level for an entire year and LIBOR increased or decreased, respectively, by 1%, our interest expense would increase or decrease, respectively, an additional $0.2 million.

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In addition, we had $49.3 million of long-term debt outstanding at December 28, 2007 carried at a weighted average fixed interest rate of 6.87% with principal payments due in various installments over a six-year period. To date, we have not used derivative financial instruments to hedge the interest rate of our investment portfolio, short-term borrowings or long-term debt, but may consider the use of derivative instruments in the future.

The estimated fair value of our cash and cash equivalents (93% of which was held abroad at December 28, 2007 and could be subject to additional taxation if it were repatriated to the United States) and the estimated fair value of our short-term borrowings under the credit facility approximated the principal amounts reflected above based on the maturities of these financial instruments.

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

Item 4. Controls and Procedures

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

(b) Changes in internal control over financial reporting. There were no changes in our internal control over financial reporting that occurred during the first quarter of fiscal year 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II

OTHER INFORMATION

Item 1. Legal Proceedings

We are subject to various legal proceedings and claims that are discussed in Note 8 of the Notes to the Condensed Consolidated Financial Statements under the caption Contingencies and in Management s Discussion and Analysis of Financial Condition and Results of Operations under the same caption, and such discussion is incorporated by reference into this item.

Item 1A. Risk Factors

The following risk factors and other information included in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended September 28, 2007 should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we presently deem less significant may also impair our business operations. If any of the following risks actually occur, our business, operating results, and financial condition could be materially adversely affected.

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

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

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

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

In January 2007, we completed the acquisition of ACCEL, a privately-held supplier of proton therapy systems for cancer treatment and scientific research instruments. The acquisition will enable us to develop and offer products for delivering image-guided, intensity-modulated proton therapy for certain types of cancers. While we intend to continue to invest in product development relating to proton therapy treatment capabilities, acceptance of this technology may be slower than with our other cancer treatment technologies due to the relatively large scale, higher costs and complex project financing

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associated with implementing a proton therapy system. Our future success will depend upon the wide-spread awareness, acceptance and adoption by the oncology market of proton therapy systems for treatment of certain cancers. Our efforts to increase awareness and adoption of our proton therapy systems may not be successful. If proton therapy fails to be effective as a treatment methodology, or if proton therapy fail to become widely accepted, our orders and revenues may not materialize.

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

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

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

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

Our success depends upon the successful development, introduction and commercialization of new generations of products, treatment systems and enhancements to and/or simplification of existing products. Our Oncology Systems products are technologically complex and must keep pace with, among other things, new product introductions of our competitors. Our X-ray Products business segment must also continually innovate to develop products with lower cost, better product quality and superior technology and performance. Accordingly, many of our products require significant planning, design, development and testing at the technological, product and manufacturing process levels. In addition, we are making significant investments in long-term growth initiatives, such as development of our SIP business through the acquisition of Bio-Imaging Research, Inc., or BIR, and entry into the proton therapy business through the acquisition of ACCEL, and expect that further efforts will be necessary to develop and commercialize some of the products and technology acquired. These activities require significant capital commitments, involvement of our senior management and other investments on our part, which we may be unable to recover. Our timeline for the development of new products or enhancements may not be

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achieved and price and profitability targets may not prove feasible. Commercialization of new products may prove challenging, and we may be required to invest more time and money than expected to successfully introduce these products. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of new products or enhancements. In addition, a few of our research and development projects are funded by government contracts. Changes in government priorities and our ability to attract similar funding may affect our overall research effort and ultimately, our ability to develop successful new products and product enhancements.

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

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

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

We cannot be sure that we will be able to successfully develop, manufacture or phase in new products, treatment systems or product enhancements. The roll-out of new products, systems and product enhancements involves compliance with complex quality assurance processes, including the Quality System Regulation, or QSR, of the U.S. Food and Drug Administration, or the FDA. Failure to complete these processes

timely and efficiently could result in delayed introduction of new products, treatment systems and product enhancements. Without the successful introduction of new products, systems and product enhancements, we may be unable to attract and retain customers, causing our revenues and operating results to suffer. Additionally, if we fail to successfully manage the transition from old products to new products, systems and product enhancements, our customers may delay or cancel orders, which would adversely affect our revenues and operating results.

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

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

We conduct business globally. Our international revenues accounted for approximately 56% and 49% of revenues during the first quarter of fiscal years 2008 and 2007, respectively. As a result, we must provide significant service and support on a worldwide basis, and we have sales and service offices located in Europe, Asia, South America and Australia. In addition, we have manufacturing and research operations in England, Germany, Switzerland, France, Finland and China. We also invested in the expansion of our China X-ray business through our recent acquisition of Pan-Pacific Enterprises, Inc., or Pan-Pacific. We have invested and will continue to invest substantial financial and management resources to develop an international infrastructure to meet the needs of our customers. We intend to continue to expand our presence in international markets, although we cannot be sure we will be able to compete successfully in the international markets, generate new business, or meet the service and support needs of our customers there. Accordingly, our future results could be harmed by a variety of factors, including:

- the difficulties in enforcing agreements and collecting receivables through many foreign country s legal systems;
- the longer payment cycles associated with many foreign customers;
- the possibility that foreign countries may impose additional withholding taxes or otherwise tax our foreign income, impose tariffs or adopt other restrictions on foreign trade;
- the fact that international regions typically have a longer period from shipment to revenue recognition resulting in greater revenue recognition deferrals, higher backlog and a lower gross margin on our products;
- our ability to obtain U.S. export licenses and other required export or import licenses or approvals;
- failure to comply with U.S. export laws and requirements which may result in civil or criminal penalties and restrictions on our ability to export our products, particularly our industrial linear accelerator products;
- changes in the political, regulatory, safety or economic conditions in a country or region; and
- the possibility that it may be more difficult to protect our intellectual property in foreign countries.

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

In addition, we generally retain cash received through international operations in our local subsidiaries. As of December 28, 2007, 93% of our cash and cash equivalents were held abroad. If these funds were repatriated to the United States, they could be subject to additional taxation, and we would not receive the full benefit of such repatriation. Additionally, this could cause our overall tax rate to increase. This could cause our business and results of operations to suffer.

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

Since we sell our products internationally and have international operations, we are also subject to market risk due to fluctuations in foreign currency exchange rates, which may affect product demand, our expenses and/or the profitability in U.S. dollars of products and services provided by us in foreign markets where payment for our products and services or of our expenses is made in the local currency. We manage this

risk through established policies and procedures that include the use of derivative financial instruments. We have historically entered into foreign currency forward exchange contracts to mitigate the effects of operational (sales orders) and balance sheet exposures to fluctuations in foreign currency exchange rates. Our forward exchange contracts generally range from one to twelve months in maturity.

Although we engage in hedging strategies that may offset the effect of fluctuations in foreign currency exchange rates, the protection these strategies provide will be affected by the timing of transactions, the effectiveness of the hedges (measured by how closely the changes in fair value of the hedging instrument offset the changes in fair value of the hedged item), the number of transactions that are hedged, forecast volatility and the extent of movement of foreign currency exchange rates. If our hedging strategies are not effective in offsetting the effect of fluctuations in foreign currency exchange rates, our operating results may be harmed. In addition, because currencies fluctuate and we engage in hedging strategies over time,

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movement in foreign currency exchange rates could impact our financial results positively or negatively in one period and not another, and therefore make comparing our financial results from period to period more difficult. Also because our hedging strategy is to protect the gross margin dollars on our orders, currency exchange rate fluctuations that positively affect our revenues may result in erosion of gross margin.

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

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

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

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

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

Our manufacturing operations are required to comply with the FDA s QSR, which addresses the design, controls, methods, facilities and quality assurance used in manufacturing, assembly, packing, storing and installing medical devices. The FDA makes announced and unannounced inspections to determine compliance with QSR and in connection with these inspections has issued, and in the future may issue, reports or written notices listing instances where we have failed to comply with applicable regulations and/or procedures or may issue Warning Letters citing failure to comply with applicable regulations or procedures. If a Warning Letter were issued, we would be required to take prompt corrective action to come into compliance. Failure to respond timely to a Warning Letter or other notice of noncompliance and to come into compliance could result in the FDA bringing enforcement action against us, which could include the shutdown of our production facilities and criminal and civil fines. Additionally, if a Warning Letter were issued, customers could delay purchasing decisions or cancel orders, and we could face increased pressure from our competitors, who could use the Warning Letter against us in competitive sales situations, either of which could adversely affect our business and stock price.

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

In addition, we are required to timely file various reports with the FDA and other regulatory authorities, including (i) reports of Corrections and Removals from the market of our devices, and (ii) reports required by the medical device reporting, or MDR, regulations and similar international regulations, which require that we report to regulatory authorities if our devices may have caused or contributed to a death or serious injury or malfunctioned in a way that would likely cause or contribute to a death or serious injury if the malfunction were to recur. If these reports are not filed timely, 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.

Our medical devices utilizing radioactive material are subject to the Nuclear Regulatory Commission, or NRC, clearance and approval requirements, and the manufacture and sale of these products are subject to extensive state regulation that varies from state to state. Our manufacture and distribution of medical devices utilizing radioactive material also requires us to obtain a number of licenses and certifications for these devices and materials. Service of these products must also be in accordance with a specific radioactive materials license. 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.

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

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

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

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

the inability to sell our products; and

criminal prosecutions.

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

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

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

WE ARE SUBJECT TO FEDERAL, STATE AND FOREIGN LAWS PROHIBITING KICKBACKS AND FALSE AND FRAUDULENT CLAIMS WHICH, IF VIOLATED, COULD SUBJECT US TO SUBSTANTIAL PENALTIES. ADDITIONALLY, ANY CHALLENGES TO OR INVESTIGATION INTO OUR PRACTICES UNDER THESE LAWS COULD CAUSE ADVERSE PUBLICITY AND BE COSTLY TO RESPOND TO, AND THUS COULD HARM OUR BUSINESS

The Medicare and Medicaid anti-kickback laws, and several similar state laws, prohibit payments or other remuneration that is intended to induce hospitals, physicians or others either to refer patients or to purchase, lease or order, or arrange for or recommend the purchase, lease or order of healthcare products or services for which payment may be made under federal healthcare programs, such as Medicare and Medicaid. These laws affect our sales, marketing and other promotional activities by limiting the kinds of financial arrangements, including sales programs, we may have with hospitals, physicians or other potential purchasers of our products. In particular, these laws influence, among other things, how we structure our sales offerings, including discounts and rebate 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.

Other federal and state laws generally prohibit individuals or entities from knowingly presenting, or causing to be presented, claims for payment from Medicare, Medicaid or other third-party payors that are false or fraudulent, or for items or services that were not provided as claimed. Although we do not submit claims directly to payors, manufacturers can be held liable under these laws if they are deemed to cause the submission of false or fraudulent claims by providing inaccurate billing or coding information to customers, or through certain other activities, including promoting products for uses not approved by the FDA, which is called off-label promotion. Anti-kickback and false claims laws prescribe civil and criminal penalties, which can be substantial, and potential exclusion from healthcare programs for noncompliance. Moreover, even an unsuccessful challenge or investigation into our practices could cause adverse publicity, and be costly to respond to, and thus could harm our business and results of operations.

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

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

Our business exposes us to potential product liability claims that are inherent in the manufacture, sale, installation, servicing and support of medical devices and other devices that deliver radiation. Because our products are involved in the intentional delivery of radiation to the human body, other situations where people may come in contact with radiation (for example, when our SIP products are being used to scan cargo), the collection and storage of patient treatment data for medical analysis

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and treatment delivery, the planning of radiation treatment and diagnostic imaging of the human body, and the diagnosing of medical problems, the possibility for significant injury and/or death exists. Our medical products are used as part of an overall process that takes place within our customers facilities and network systems, and under quality assurance, or QA, procedures established by the facility that ultimately result in the delivery of radiation to patients. Additionally, human and other errors or accidents may arise from the fact that our products operate in complex environments with products from other vendors, where interoperability or data sharing protocol may not be optimized even though the equipment or system operate according to specifications. As a result, we may face substantial liability to patients, our customers or others for damages resulting from the faulty or allegedly faulty design, manufacture, installation, servicing, support, testing, interoperability or the misuse of our products. 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. With any accident, we could be subject to legal costs, adverse publicity and damage to our reputation, whether or not our products or services were a factor. Furthermore, adverse publicity regarding accidents or mistreatments involving radiation therapy could adversely impact our business by negatively affecting the reputation of radiation therapy in general, causing patients to question the efficacy of radiation therapy as a viable treatment for cancer and seek other modalities of treatment.

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

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

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

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

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The market for X-ray imaging components and subsystems is extremely competitive, with our competitors frequently having greater financial, marketing and other resources than we have. Some of the major diagnostic imaging systems companies, which are the primary OEMs for our X-ray tubes, also manufacture X-ray tubes for use in their own imaging systems products. We must compete with these in-house manufacturing operations that are naturally favored by their affiliated companies. As a result, we must have a competitive advantage in one or more significant areas, which may include lower product cost, better product quality or superior technology and performance. We sell a significant volume of our X-ray tubes to OEMs such as Toshiba Corporation, Hitachi Medical Corporation, Philips Medical Systems and GE Healthcare, all of which have in-house X-ray tube production capability. In addition, we compete against other stand-alone X-ray tube manufacturers such as Comet AG and IAE Industria Applicazioni Elettroniche Spa. These companies compete with us for both the OEM business and the independent servicing business for X-ray tubes. The market for flat panel detectors is also very competitive, and we primarily compete against Perkin-Elmer, Inc., Trixell S.A.S., Canon, Inc. and Hologic, Inc. in our flat panel detector product line.

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

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

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

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

As radiation therapy becomes more and more complex, our customers are increasingly concerned about the interoperability and compatibility of the various products they use in providing treatment to patients. For example, our linear accelerators, treatment simulators, treatment verification products, treatment planning and information management software products are designed to interoperate with one another, and to be compatible with other widely used third-party radiation oncology products. Obtaining and maintaining this interoperability and compatibility is costly and time-consuming. When third parties modify the design or functionality of their products, it can require us to modify our products to ensure compatibility.

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Conversely, when we implement design improvements to our products, customers may be reluctant to adopt our new technology due to interoperability issues; for example, a clinic may be unwilling to implement one of our new technologies because its third-party software network provider does not yet have a proper software interface available. In addition, our ability to obtain compatibility with third-party products can depend on the third parties providing us with adequate information regarding their products. In many cases, these third parties are our competitors and may time their product changes, and their sharing of relevant information with us, to place us at a competitive disadvantage. Further, we could be required to obtain additional regulatory clearances for any modification of our products due to interoperability issues with the products of third parties. It is also possible that, despite our best efforts, we may be unable to make our products interoperable or compatible with widely used third-party products or may only be able to do so at a prohibitive expense, making our products less attractive or more costly to our customers.

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

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

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

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

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

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

We obtain some of the components and subassemblies included in our products from a limited group of suppliers, or in some cases a single-source supplier. Examples include the source wires for high-dose afterloaders; klystrons for linear accelerators; imaging panels; non-coated array sensors; coating for array sensors for the flat panel detectors; specialized integrated circuits for imaging subassemblies; and some targets, housings and glass bulbs for X-ray tubes. If we lose any of these suppliers or if their operations were substantially interrupted, we would be required to obtain and qualify one or more replacement suppliers, which may then also require us to redesign or modify our products to incorporate new parts and/or further require us to obtain clearance, qualification or certification of such product by the FDA or other applicable regulatory approvals in other countries. Events like these could significantly increase costs for the affected product and likely cause material delays in delivery of that and other related products. Although we have obtained limited insurance to protect against business interruption loss, we cannot assure you that this insurance coverage will be adequate or that it will continue to remain available on acceptable terms, if at all. Additionally, some of these suppliers, including our single-source suppliers, supply components for certain of our growing product lines that are growing rapidly. Manufacturing capacity limitations of any of these suppliers or other inability of these suppliers to meet increasing demand could adversely affect us, resulting in curtailed growth opportunities for any of our product lines. Shortage of and greater demand for components and subassemblies could also increase manufacturing costs by increasing prices. Disruptions or loss of any of our limited- or sole-source components or subassemblies or the capacity limitations of the suppliers for these components or subassemblies, including the ones referenced above, could adversely affect our business and financial results and could damage our customer relationships. In addition, we rely upon the supplies of certain raw materials such as tungsten, lead and copper for Oncology Systems, lead and rhenium for X-ray Products, tungsten for SIP and high-grade steel and high-grade copper for ACCEL. Demand for these raw materials from foreign countries, such as China, has increased dramatically. As a result, the availability of these raw materials has been and may continue to be limited and their prices have increased and may continue to increase significantly. This could constrain our manufacturing of affected products, reduce our profit margins or otherwise adversely affect our business.

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

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

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

Our SIP business, including newly acquired BIR, designs, manufactures, sells and services Linatron X-ray accelerators and imaging hardware and software products for security and inspection, as well as non-destructive testing and research purposes. We generally sell our accelerators and imaging products to OEMs who incorporate them into their inspection products, which are then sold to customs agencies and other government agencies, as well as to commercial private parties. We believe growth in this business will be driven by security cargo screening and border protection needs, as well as by the needs of customs agencies to verify shipments for assessing duties and taxes. However, use of linear accelerator and imaging technology in security cargo screening and border protection is in its early stages. Orders for our SIP products have been and may continue to be unpredictable and the actual timing of sales and revenue recognition will vary significantly, as it is difficult to predict our OEM customer delivery and acceptance schedules.

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

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

In order to achieve market acceptance for our radiation therapy products, we are often required to educate physicians about the use of a new treatment procedure such as IMRT, IGRT, stereotactic radiosurgery or proton therapy, overcome physician objections to some of the effects of the product or its related treatment regimen, convince healthcare payors that the benefits of the product and its related treatment process outweigh its costs and help train qualified physicists in the skilled use of our products. For example, the complexity and dynamic nature of IMRT and IGRT requires significant education of hospital personnel and physicians regarding the benefits of IMRT and IGRT and the required departures from their customary practices. Further, the complexity and high cost of proton therapy requires similar significant education, as well as education regarding construction and facility requirements. We have expended and will continue to expend significant resources on marketing and educational efforts to create awareness of IMRT, IGRT, stereotactic radiosurgery and proton therapy generally and to encourage acceptance and adoption of our products for IMRT, IGRT, stereotactic radiosurgery and proton therapy. The timing of our competitors introduction of products and the market acceptance of their products may also make this educational process more difficult. We cannot be sure that any products we develop will gain any significant market acceptance and market share among physicians, patients and healthcare payors, even if the required regulatory approvals are obtained.

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

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

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

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

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

Our success will depend, in part, on our ability to expand our product offerings and grow our businesses in response to changing technologies, customer demands and competitive pressures. In some circumstances, as a strategy to achieve quicker time to market for new products or technology, or to enter new markets, we may determine to grow our business through the acquisition of complementary businesses, products or technologies rather than through internal development. For

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example, in fiscal year 2007 we acquired ACCEL, a privately-held German supplier of scientific research instruments and proton therapy systems for cancer treatment, and BIR, a privately-held supplier of X-ray imaging products for security and inspection, and in fiscal year 2008 we acquired Pan-Pacific, an independent distributor of medical X-ray tubes and other imaging components in China. The identification of suitable acquisition candidates can be difficult, time-consuming and costly, and we may not be able to identify suitable candidates or successfully complete identified acquisitions. In addition, the completion of an acquisition could divert our management and key personnel from our business operations, which could harm our business and affect our financial results. Furthermore, even if we complete an acquisition, we may not be able to successfully integrate newly acquired organizations, products or technologies or employees into our operations, or may not be able to realize some of the synergies expected from an acquisition. The process of integration could be expensive, time-consuming and may strain our resources. For example, we may encounter challenges in the commercialization of new products and may have to invest more than originally anticipated in order to do so, as we are experiencing with ACCEL s proton therapy systems. These additional expenditures could be significant and could cause our results of operations to suffer. In many instances, integrating a new business will also involve implementing or improving internal controls appropriate for a public company at a business that lacks them. In addition, we may be unable to retain the employees of acquired companies, or the acquired company s customers, suppliers, distributors or other partners for a variety of reasons, including the fact that these entities may be our competitors or may have close relationships with our competitors. Further, we may find that we need to restructure acquired businesses, and we cannot be certain that the restructuring activities will produce the full efficiencies and benefits we expect. Consequently, we may not achieve anticipated growth or other benefits from an acquisition, which could harm our existing business. In addition, acquisitions could result in potentially dilutive issuances of equity securities or the incurrence of debt, contingent liabilities or expenses, or other charges such as in-process research and development, any of which could harm our business and affect our financial results.

We account for our acquisitions under the purchase method of accounting. Under this method, we allocate the total purchase price to the acquired businesses tangible assets and liabilities, identifiable intangible assets and in-process research and development costs based on their fair values as of the date of the acquisition, and record the excess of the purchase price over those fair values as goodwill. If we fail to achieve the anticipated growth from an acquisition, we may be required to write down the value of our intangible assets and goodwill, which may harm of our financial results.

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

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

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

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

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

The United States government has in the past, and may in the future, consider healthcare policies and proposals intended to curb rising healthcare costs, including those that could significantly affect both private and public reimbursement for healthcare services. State and local governments, as well as a number of foreign governments, are also considering or have

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adopted such policies. These policies have included, and may in the future include, rationing of government-funded reimbursement for healthcare services and imposing price controls on medical products and services providers. Future significant changes in the healthcare systems in the United States or elsewhere, including those that may reduce reimbursement rates for our products or procedures using our products, could have a negative impact on the demand for our products and services and our business. We are unable to predict what healthcare reform legislation or regulations, if any, will be enacted in the United States or elsewhere, whether other healthcare legislation or regulations affecting our business may be proposed or enacted in the future, or what effect any legislation or regulation would have on our business.

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

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

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

We have experienced and expect in the future to experience fluctuations in our operating results, including net orders, revenues and gross margins. Many of our products require significant capital expenditures by our customers. Accordingly, individual product orders can be quite large in dollar amounts, which can extend the customer purchasing cycle. We have experienced this with our IGRT products, and expect this to extend to our proton therapy and scientific research instruments products because of the high cost of the equipment and the complexity of project financing. We also expect that orders (and related revenues) for ACCEL scientific research instruments products will vary as they are tied primarily to large, government or national laboratory research projects. Timing of order placement from customers, including those in the government or public sector, and their willingness to commit to purchase products are inherently difficult to predict or forecast. In addition, some of our more sophisticated equipment, such as IGRT and proton therapy products, requires greater site preparation and longer construction cycles, which can delay installation. For proton therapy products, this can delay the customer decision cycles even further. The timing of when individual orders are placed, installation is accomplished and the revenues recognized could have an effect our quarterly results.

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

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

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

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changes in our or our competitors pricing or discount levels;

changes or anticipated changes in third-party reimbursement amounts or policies applicable to treatments using our products;

revenues becoming affected by seasonal influences;

timing of revenue recognition;

changes in foreign currency exchange rates;

changes in the relative portion of our revenues represented by our various products, including the relative mix between higher margin and lower margin products;

changes in the relative portion of our revenues represented by the international region;

timing of the announcement, introduction and delivery of new products or product enhancements by us and by our competitors;

disruptions in the supply or changes in the costs of raw materials, labor, product components or transportation services;

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

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

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

the unfavorable outcome of any litigation;

misleading information in the financial community; and

accounting adjustments, such as those relating to accounting reserves for product recalls, reserves for excess and obsolete inventories, share-based compensation expense as required under SFAS 123(R), fluctuation in our effective tax rates, 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 ACCEL products, which are presently below the gross margins for our traditional radiotherapy products. If our gross margins fall below the expectation of securities analysts and investors, the trading price of our common stock would almost certainly decline.

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

THE FINANCIAL RESULTS OF OUR PROTON THERAPY AND RESEARCH INSTRUMENTS BUSINESS MAY FLUCTUATE AND BE UNPREDICTABLE

The proton therapy and scientific research instruments projects of our ACCEL business are highly customized and vary in size and complexity. Planning for these projects will take more time and use more resources than those in the radiotherapy

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business conducted in our Oncology Systems segment. Due to its relatively large scale, the construction of a proton therapy facility requires significant capital investment and may involve complex project financing. If we are required to establish special purpose entities to finance and manage a proton therapy project, we may be required to consolidate these special purpose entities in our financial statements, or guarantee performance and assume liabilities that are in excess of the project value, which could negatively impact our financial results. In the scientific research instruments market, projects are generally publicly funded, and decisions on new projects or project upgrades are subject to public and political factors. Therefore, sales and customer decision cycles may take several years. As a result, the timing of proton therapy and scientific research instruments projects may vary significantly from period to period, and our operating results and stock price may be adversely affected.

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

Moreover, entrance into the proton therapy and scientific research instruments business may subject us to increased risk and potential liability. For example, because proton therapy projects are large in scale and require detailed project planning, failure to deliver on our commitments could result in greater than expected liabilities, as we could be required to indemnify business partners and customers for losses suffered or incurred if we are unable to deliver our products in accordance with the terms of customer contracts. These indemnification arrangements would be limited to a percentage of the value of the project; however, due to the high dollar value of proton therapy projects, the liability that we would assume may nevertheless be substantial. Additionally, while the proton therapy market is still developing and technology efficacy of proton therapy as an accepted treatment modality being established, customers are requesting that the systems vendor, as the primary technology provider, provide guarantees for and suffer penalties in relation to the overall construction project. Since each proton therapy center project may cost up to $100 million, the amount of potential liability may be higher than the levels historically assumed by us for our traditional radiation therapy business. Insurance covering these contingencies may be unobtainable. If we cannot reasonably mitigate or eliminate these contingencies, our ability to competitively bid upon proton center projects will be negatively impacted and we may be required to assume material amounts of potential liability, all of which may have adverse consequences to our Proton Therapy business. In addition, we have encountered and may encounter additional challenges in the commercialization of the proton therapy products, which may increase our research and development costs and delay the introduction of our products. This and other unanticipated events could adversely affect our business and make our results of operations unpredictable.

WE PLAN TO UPGRADE AND MODIFY OUR ENTERPRISE RESOURCE PLANNING AND OTHER KEY SOFTWARE APPLICATIONS, WHICH COULD CAUSE UNEXPECTED PROBLEMS TO OCCUR AND COULD DISRUPT THE MANAGEMENT OF OUR BUSINESS.

We plan to upgrade and modify the enterprise resource planning, or ERP, system used for our worldwide operations, as well as other key software applications used in our global operations. Our ERP system is integral to our ability to accurately and efficiently maintain our books and records, record transactions, manage our personnel records, provide critical information to our management and prepare our financial statements. The planned upgrade involves some process re-engineering, and may eventually become more costly, difficult and time-consuming to purchase and implement than we currently anticipate. In addition, we may encounter unexpected difficulties, costs or other challenges with this upgrade and any modifications, any of which may disrupt our business or result in significant deficiencies or material weakness in our internal control over financial reporting. Corrections and improvements may be required as we upgrade and modify our systems, procedures and controls, and could cause us to incur additional costs and require additional management attention, placing burdens on our internal resources. If we fail to manage these changes effectively, it could adversely affect our ability to manage our business and, as a further consequence, affect our operating results.

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

We maintain a revolving credit facility that contains restrictive financial covenants, including financial covenants that require us to maintain compliance with specified financial ratios. We may have to curtail some of our operations to maintain compliance 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

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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 have difficulty securing additional financing in the form of additional indebtedness. Furthermore, if we fail to comply with these covenants, requirements or any other provision of the credit facility, we may be in default under the credit facility, and we cannot assure you that we will be able to obtain the necessary amendments or waivers of a default. Upon an event of default under our credit facility not otherwise amended or waived, the lender could elect to declare all amounts outstanding under our revolving credit facility, together with accrued interest, to be immediately due and payable. If the payment of our indebtedness is accelerated, we cannot assure you that we will 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 with GAAP. These principles are subject to interpretation by the Financial Accounting Standards Board, American Institute of Certified Public Accountants, the Securities and Exchange Commission and various other regulatory or accounting bodies. A change in interpretations of, or our application of, these principles can have a significant effect on our reported results and may even affect our reporting of transactions completed before a change is announced. Additionally, as 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. For example, as a result of our adoption of FIN 48, our effective tax rate and other related financial metrics may fluctuate more than they have in 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 those regarding revenue recognition, than we had applied in past periods. For example, if we develop products that contain more software components, we may be required to recognize revenue for the software components together with the hardware components in accordance with software revenue recognition rules, which could delay recognition of some revenue. Additionally, while we recognize revenue for many of our Oncology Systems products in accordance with Staff Accounting Bulletin No. 104 Revenue Recognition and SOP No. 97-2, *Software Revenue Recognition*, as amended by SOP No. 98-9, *Software Revenue Recognition with Respect to Certain Agreements*, we recognize revenues using the percentage-of-completion method for certain contracts for products and services in the ACCEL Proton Therapy and Research Instruments businesses and certain products and services in the SIP business, in accordance with SOP 81-1, *Accounting for Performance of Construction-Type and Certain Product Type Contracts*, which will affect the timing of revenue recognition. Under the percentage-of-completion method of accounting, sales and gross profit are recognized as work is performed based on the relationship between actual costs incurred and total estimated costs at the completion of the contract. If a loss is expected on a contract, the estimated loss would be charged to cost of sales in the period the loss is identified. Because 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, and because the estimates must be periodically reviewed and appropriately adjusted, if our estimates are not accurate or circumstances change over time, we would be required to adjust revenues or even record a contract loss, and our financial results could suffer. While we currently apply the percentage-of-completion method of accounting to certain contracts for products and services in the Proton Therapy and Research Instruments businesses and certain products and services in the SIP business, we could be required to apply them to other businesses in the future. The application of different types of accounting principles and related potential adjustments may make it more difficult to compare our financial results from quarter to quarter, and the trading price of our common stock could suffer or become more volatile as a result.

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

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

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

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

We offer longer or extended payment terms for qualified customers in some circumstances. During the first quarter of fiscal year 2008, customer contracts with longer or extended payment terms amounted to approximately 5% of total Oncology Systems revenues. While we qualify customers to whom we offer longer or extended payment terms, we cannot assure you that the financial positions of these customers will not change adversely over the longer time period given for payment. In such an event, we may experience an increase in payment defaults in our accounts receivable, which will affect our net earnings. Also, longer or extended payment terms have and may in the future result in an increase in our days sales outstanding.

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

We conduct a significant portion of our activities, including manufacturing, administration and data processing at facilities located in the State of California and other seismically active areas that have experienced major earthquakes in the past, as well as other natural disasters. We carry limited earthquake insurance. This coverage may not be adequate or continue to be available at commercially reasonable rates and terms. A major earthquake or other disaster affecting our facilities, 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 manufacturing facilities; these delays could be lengthy and result in large expenses. If any of our customers facilities are adversely affected by a natural disaster, shipments of our products could be delayed even further. In addition, our facilities, particularly those located in the western states of the United States, may be subject to a shortage of available electrical power and other energy supplies. Any shortages may increase our costs for power and energy supplies or could result in blackouts, which could disrupt the operations of our affected facilities and harm our business. Further, our products are typically shipped from a limited number of ports, and any natural disaster, strike or other event blocking shipment from these ports could delay or prevent shipments and harm our business.

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

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

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

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

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

(a) Not applicable

(b) Not applicable

(c) The following table provides information with respect to the shares of common stock repurchased by us during the first quarter of fiscal year 2008.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)
September 29, 2007 - October 26, 2007	582,100	$ 42.10	582,100	10,417,900
October 27, 2007 - November 23, 2007	206,400 (2)	$ 49.05 (2)	200,000	10,217,900
November 24, 2006 - December 28, 2007	137,900	$ 49.85	137,900	10,080,000
Total	926,400	$ 44.80	920,000	

(1) On July 24, 2007, our Board of Directors approved the repurchase of 12,000,000 shares of our common stock over a period beginning on July 30, 2007 through December 31, 2008. We expect repurchases will be made in accordance with Rule 10b-18 and include a plan designed to satisfy the Rule 10b5-1 safe harbor. Shares will be retired upon repurchase.

(2) Includes 6,400 shares of VMS common stock that were tendered to VMS for employees taxes withheld for vested restricted common stock under the Amended and Restated 2005 Omnibus Stock Plan.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

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Item 6. Exhibits

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

Exhibit No.	Description
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.

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SIGNATURES

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

VARIAN MEDICAL SYSTEMS, INC.

(Registrant)

Dated: February 5, 2008

By: /s/ **Elisha W. Finney**
Elisha W. Finney

Senior Vice President, Finance and

Chief Financial Officer

(Duly Authorized Officer and

Principal Financial Officer)

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