ACCURAY INC
Form 10-Q
February 08, 2012
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

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

**For the quarterly period ended December 31, 2011**

**or**

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

**For the transition period from to**

**Commission File Number: 001-33301**

# ACCURAY INCORPORATED

(Exact Name of Registrant as Specified in Its Charter)

| **Delaware** | **20-8370041** |
| --- | --- |
| (State or Other Jurisdiction of Incorporation or Organization) | (IRS Employer Identification Number) |

**1310 Chesapeake Terrace**

**Sunnyvale, California 94089**

(Address of Principal Executive Offices Including Zip Code)

**(408) 716-4600**

(Registrant s Telephone Number, Including Area Code)

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

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

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

| | |
| --- | --- |
| Large accelerated filer o | Accelerated filer x |
| Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

As of January 14, 2012, there were 71,053,981 shares of the Registrant s Common Stock, par value $0.001 per share, outstanding.

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**Accuray Incorporated**

**Form 10-Q for the Quarter Ended December 31, 2011**

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**PART I. FINANCIAL INFORMATION**

**Item 1. Condensed Consolidated Financial Statements**

**Accuray Incorporated**

**Condensed Consolidated Balance Sheets**

(in thousands, except share and per share amounts)

| | December 31, 2011 (unaudited) | June 30, 2011 (1) |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 148,467 | $ 95,906 |
| Restricted cash | 3,502 | 3,172 |
| Accounts receivable, net of allowance for doubtful accounts of $1,650 and $324 at December 31, 2011 and June 30, 2011, respectively | 73,928 | 61,853 |
| Inventories | 82,881 | 97,836 |
| Prepaid expenses and other current assets | 12,481 | 21,115 |
| Deferred cost of revenue current | 6,893 | 5,840 |
| Total current assets | 328,152 | 285,722 |
| | | |
| Property and equipment, net | 40,825 | 44,823 |
| Goodwill | 56,187 | 54,474 |
| Intangible assets, net | 57,865 | 66,039 |
| Deferred cost of revenue noncurrent | 2,945 | 2,258 |
| Other assets | 6,062 | 2,468 |
| Total assets | $ 492,036 | $ 455,784 |
| **Liabilities and equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 22,017 | $ 38,645 |
| Accrued compensation | 19,175 | 27,406 |
| Other accrued liabilities | 23,659 | 43,012 |
| Customer advances | 22,968 | 25,829 |
| Deferred revenue current | 83,552 | 68,152 |
| Total current liabilities | 171,371 | 203,044 |
| Long-term liabilities: | | |
| Long-term other liabilities | 5,744 | 6,321 |
| Deferred revenue noncurrent | 5,997 | 6,092 |
| Long-term debt | 77,468 | |
| Total liabilities | 260,580 | 215,457 |
| Commitments and contingencies (Note 7) | | |
| Equity: | | |
| Preferred stock, $0.001 par value; authorized: 5,000,000 shares; no shares issued and outstanding | | |
| Common stock, $0.001 par value; authorized: 100,000,000 shares; issued: 73,145,513 and 72,199,837 shares at December 31, 2011 and June 30, 2011, respectively; outstanding: | 71 | 70 |

| | | | | |
|---|---|---|---|---|
| 71,005,545 and 70,059,819 shares at December 31, 2011 and June 30, 2011, respectively | | | | |
| Additional paid-in capital | | 402,998 | | 373,963 |
| Accumulated other comprehensive income | | 2,494 | | 127 |
| Accumulated deficit | | (181,282) | | (144,385) |
| Total stockholders equity | | 224,281 | | 229,775 |
| Noncontrolling interest | | 7,175 | | 10,552 |
| Total equity | | 231,456 | | 240,327 |
| Total liabilities and equity | $ | 492,036 | $ | 455,784 |

(1) The condensed consolidated balance sheet at June 30, 2011 has been derived from audited consolidated financial statements.

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

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**Accuray Incorporated**

**Condensed Consolidated Statements of Operations**

(in thousands, except per share amounts)

(Unaudited)

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Net revenue: | | | | |
| Products | $ 63,802 | $ 35,271 | $ 119,976 | $ 55,187 |
| Services | 42,097 | 18,846 | 85,498 | 36,580 |
| Other | 524 | 129 | 1,400 | 547 |
| Total net revenue | 106,423 | 54,246 | 206,874 | 92,314 |
| Cost of revenue: | | | | |
| Cost of products | 32,800 | 13,256 | 71,173 | 20,753 |
| Cost of services | 33,177 | 11,380 | 70,526 | 23,180 |
| Cost of other | 203 | 144 | 504 | 678 |
| Total cost of revenue | 66,180 | 24,780 | 142,203 | 44,611 |
| Gross profit | 40,243 | 29,466 | 64,671 | 47,703 |
| Operating expenses: | | | | |
| Selling and marketing | 14,017 | 7,987 | 27,598 | 15,747 |
| Research and development | 19,874 | 9,313 | 40,439 | 17,360 |
| General and administrative | 13,663 | 8,481 | 28,632 | 17,040 |
| Total operating expenses | 47,554 | 25,781 | 96,669 | 50,147 |
| Income (loss) from operations | (7,311) | 3,685 | (31,998) | (2,444) |
| Other income (expense), net | (4,513) | 676 | (7,371) | 2,292 |
| Income (loss) before provision for income taxes | (11,824) | 4,361 | (39,369) | (152) |
| Provision for income taxes | 367 | 263 | 905 | 390 |
| Net income (loss) | (12,191) | 4,098 | (40,274) | (542) |
| Noncontrolling interest | (1,804) | | (3,377) | |
| Net income (loss) attributable to stockholders | $ (10,387) | $ 4,098 | $ (36,897) | $ (542) |
| | | | | |
| Net income (loss) per share: | | | | |
| Basic | $ (0.15) | $ 0.07 | $ (0.52) | $ (0.01) |
| Diluted | $ (0.15) | $ 0.07 | $ (0.52) | $ (0.01) |
| Weighted average common shares used in computing net income (loss) per share | | | | |
| Basic | 70,698 | 59,282 | 70,481 | 58,975 |
| Diluted | 70,698 | 61,376 | 70,481 | 58,975 |

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

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**Accuray Incorporated**

**Condensed Consolidated Statements of Cash Flows**

(in thousands)

(Unaudited)

| | Six Months Ended December 31, | |
|---|---|---|
| | **2011** | **2010** |
| **Cash Flows From Operating Activities** | | |
| Net loss | $ (40,274) | $ (542) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 16,521 | 2,890 |
| Share-based compensation | 4,556 | 4,451 |
| Realized gain on investments | | (3) |
| Accretion of interest on long-term debt | 1,597 | |
| Provision for bad debts | 1,342 | 136 |
| Provision for write-down of inventories | 1,020 | 675 |
| Loss (gain) on disposal of property and equipment | 166 | (117) |
| Changes in assets and liabilities: | | |
| Restricted cash | (335) | |
| Accounts receivable | (15,036) | 8,480 |
| Inventories | 12,104 | (8,783) |
| Prepaid expenses and other current assets | 8,406 | 796 |
| Deferred cost of revenue | (1,751) | 5,315 |
| Other assets | (703) | (15) |
| Accounts payable | (16,974) | (4,009) |
| Accrued liabilities | (23,800) | (802) |
| Customer advances | (2,460) | 631 |
| Deferred revenue | 17,204 | (8,888) |
| Net cash (used in) provided by operating activities | (38,417) | 215 |
| **Cash Flows From Investing Activities** | | |
| Purchases of property and equipment , net | (3,900) | (3,250) |
| Acquisition of business | (1,384) | |
| Purchase of investments | | (71,619) |
| Sale and maturity of investments | | 74,929 |
| Net cash (used in) provided by investing activities | (5,284) | 60 |
| **Cash Flows From Financing Activities** | | |
| Proceeds from issuance of common stock | 978 | 2,543 |
| Proceeds from employee stock purchase plan | 1,052 | 973 |
| Proceeds from debt, net of costs | 96,100 | |
| Net cash provided by financing activities | 98,130 | 3,516 |
| Effect of exchange rate changes on cash | (1,868) | 288 |
| Net increase in cash and cash equivalents | 52,561 | 4,079 |
| Cash and cash equivalents at beginning of period | 95,906 | 45,434 |
| Cash and cash equivalents at end of period | $ 148,467 | $ 49,513 |

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

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**Accuray Incorporated**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**1. Description of Business**

**Organization**

Accuray Incorporated (together with its subsidiaries, the Company ) is incorporated in Delaware. The Company designs, develops and sells advanced medical radiation systems for the treatment of tumors throughout the body. The CyberKnife Systems are advanced, image-guided robotic systems used to deliver radiosurgery for the treatment of solid tumors anywhere in the body.

On June 10, 2011, the Company completed the acquisition of TomoTherapy Incorporated ( TomoTherapy ) by acquiring all of TomoTherapy s common stock in exchange for cash and shares of Accuray common stock. TomoTherapy designs, manufactures and sells systems used to deliver advanced radiation therapy for the treatment of a wide range of cancer types. The condensed consolidated financial statements include the financial results of TomoTherapy prospectively from the date of acquisition.

**2. Summary of Significant Accounting Policies**

**Basis of Presentation and Principles of Consolidation**

The condensed consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries and a variable interest entity, Compact Particle Acceleration Corporation ( CPAC ) (for further information, see Note 11, Investment in CPAC ). All significant inter-company transactions and balances have been eliminated in consolidation.

The accompanying condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles, ( GAAP ), pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC ). Certain information and note disclosures have been condensed or omitted pursuant to such rules and regulations. The unaudited condensed consolidated financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary for a fair presentation of the periods presented. The results for the three and six months ended December 31, 2011 are not necessarily indicative of the results to be expected for the year ending June 30, 2012, for any other interim period or for any future year.

**Use of Estimates**

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

**Foreign Currency**

The Company s international subsidiaries use their local currencies as their functional currencies. For those subsidiaries, assets and liabilities are translated at exchange rates in effect at the balance sheet date and income and expense accounts at the average exchange rate. Resulting translation adjustments are excluded from the determination of net income and are recorded in accumulated other comprehensive income as a separate component of stockholders equity. Net foreign currency exchange transaction gains or losses are included as a component of other income (expense), net, in the Company s condensed consolidated statements of operations.

**Cash and Cash Equivalents**

Cash equivalents consist of amounts invested in highly liquid investment accounts with original maturities of three months or less on the date of purchase and money market accounts.

**Restricted Cash**

Restricted cash primarily relates to funds held related to Value-Added Tax ( VAT ) guarantees in a foreign jurisdiction and certain performance obligation guarantees.

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**Fair Value of Financial Instruments**

The carrying values of the Company s financial instruments including cash equivalents, restricted cash, accounts receivable and accounts payable are approximately equal to their respective fair values due to the relatively short-term nature of these instruments. The fair value of the 3.75% Convertible Senior Notes due August 1, 2016 (the Notes ) was $78.3 million at December 31, 2011, which was based on the quoted market price on December 30, 2011 (the last trading day during the three and six months ended December 31, 2011).

**Concentration of Credit and Other Risks**

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

For the three and six months ended December 31, 2011 and 2010, there were no customers that represented 10% or more of total net revenue. At December 31, 2011 and June 30, 2011, there were no customers and one customer, respectively, whose accounts receivable balance was 10% or more of the Company s total accounts receivable.

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

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

**Inventories**

Inventories are stated at the lower of cost (on a first-in, first-out basis) or market value. Excess and obsolete inventories are written down based on historical sales and forecasted demand, as judged by management. The Company determines inventory and product costs, which include allocated production overheads, through use of standard costs.

**Revenue Recognition**

The Company earns revenue from the sale of products, the operation of its shared ownership program, and the provision of related services, which include installation services, post-contract customer support ( PCS ), training and other professional services. The Company records its revenues net of any value added or sales tax. From time to time, the Company introduces customers to third party financing organizations. No amounts received from these third party financing organizations are at risk.

In the first quarter of fiscal 2011, the Company adopted Accounting Standards Update ( ASU ) 2009-13, *Multiple-Deliverable Revenue Arrangements,* and ASU 2009-14, *Certain Arrangements That Include Software Elements*. These standards change the requirements for establishing separate units of accounting in a multiple element arrangement and require the allocation of arrangement consideration to each deliverable to be based on the relative selling price. The Financial Accounting Standards Board ( FASB ) also amended the accounting standards for revenue recognition to exclude software that is contained in a tangible product from the scope of software revenue guidance if the software is essential to the tangible product s functionality. The Company adopted these new standards on a prospective basis. For revenue arrangements that were entered into or materially modified after the adoption of these standards, implementation of this new authoritative guidance had an insignificant impact on the Company s reported net revenue since the first quarter of fiscal 2011 as compared to net revenue if the related arrangements entered into or modified after the effective date were subject to the accounting requirements in effect in the prior year.

The Company frequently enters into sales arrangements with customers that contain multiple elements or deliverables. For revenue arrangements with multiple elements which were entered into prior to the adoption of the new standards and which have not subsequently been materially modified, the Company allocates arrangement consideration to each element based upon vendor specific objective evidence ( VSOE ) of fair value of the respective elements. VSOE of fair value for each element is based upon the Company s standard rates charged for the product or service when such product or service is sold separately or based upon the price established by the Company s pricing committee when that product or service is not yet being sold separately. When contracts contain multiple elements, and VSOE of fair value exists for all undelivered elements, the Company accounts for the delivered elements, principally the system and optional product upgrades, based upon the residual method. If VSOE of fair value does not exist for all the undelivered elements, all revenue is deferred until the earlier of: (1) delivery of all elements, and (2) establishment of VSOE of fair value for all remaining undelivered elements.

Under the new accounting guidance, in evaluating revenue recognition for arrangements which contain multiple deliverables, the Company determined that in certain instances it was not able to establish VSOE for all deliverables in an arrangement as the Company

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infrequently sells each element on a stand-alone basis, does not price products within a narrow range, or has a limited sales history. When VSOE cannot be established, the Company attempts to establish the selling price of each element based on relevant third-party evidence ( TPE ). TPE is determined based on competitors prices for similar deliverables when sold separately. Generally, the Company s offerings contain a significant level of proprietary technology, customization or differentiation such that the comparable pricing of products with similar functionality cannot be obtained. Furthermore, the Company is unable to reliably determine what similar competitors products selling prices are on a stand-alone basis. Therefore, the Company typically is not able to determine TPE.

When the Company is unable to establish selling price using VSOE or TPE, the Company uses its best estimate of selling price ( BESP ) in the Company s allocation of arrangement consideration. The objective of BESP is to determine the price at which the Company would transact a sale if the product or service were sold on a stand-alone basis. BESP is generally used for offerings that are not typically sold on a stand-alone basis or for new or highly customized offerings. The Company determines BESP for a product or service by considering multiple factors including, but not limited to, pricing practices, internal costs, geographies and gross margin. The determination of BESP is made through consultation with and formal approval by the Company s pricing committee, taking into consideration the overall go-to-market pricing strategy.

As the Company s go-to-market strategies and other factors evolve, the Company may modify its pricing practices in the future, which could result in changes in selling prices, including VSOE, TPE and BESP. As a result, the Company s future revenue recognition for multiple element arrangements could differ materially from that recorded in the current period. The Company regularly reviews VSOE, TPE and BESP and maintains internal controls over the establishment and update of these inputs.

The Company has a limited number of software offerings which are not required to deliver the tangible product s essential functionality and can be sold separately. Revenues from sales of these software products and related post-contract support are accounted for under software revenue recognition rules. The Company s multiple-element arrangements may therefore have a software deliverable that is subject to the existing software revenue recognition guidance. The revenue for these multiple-element arrangements is allocated to the software deliverable or group of software deliverables and the non-software deliverables based on the relative selling prices of all of the deliverables in the arrangement using the hierarchy in the new revenue recognition accounting guidance.

The Company recognizes product revenues when there is persuasive evidence of an arrangement, the fee is fixed or determinable, collection of the fee is probable and delivery has occurred. Payments received in advance of product shipment are recorded as customer advances and are recognized as revenue or deferred revenue upon product shipment or installation.

The Company assesses the probability of collection based on a number of factors, including past transaction history with the customer and the credit-worthiness of the customer. The Company generally does not request collateral from its customers. If the Company determines that collection is not probable, the Company will defer the fee and recognize revenue upon receipt of cash.

The Company records revenues from sales of systems to distributors on either a sell-through or sell-in basis, depending on the terms of the distribution agreement as well as terms and conditions executed for each sale, and once all revenue recognition criteria have been met. For sales of product upgrades and accessories to distributors, revenue is recognized on either a sell-through or sell-in basis, depending upon the terms of the purchase order or signed quotation and once all revenue recognition criteria have been met.

The Company s agreements with customers and distributors for system sales generally do not contain product return rights. Certain distributor agreements include parts inventory buy-back provisions upon distributorship termination. The Company accrues an inventory buy-back liability when and if such distributorship termination is expected.

*Product Revenue*

The majority of product revenue is generated from sales of the systems. The Company sells its systems with PCS contracts that provide for upgrades when and if they become available, training points and at times, professional services. If the Company is responsible for installation, the Company recognizes revenue only after installation and acceptance of the system. Otherwise, revenue is recognized upon delivery.

*Service Revenue*

Service revenue is generated primarily from warranty services, post warranty services, installation services, unspecified when and if available product upgrades, training, and professional services. Warranty and post warranty service revenue is deferred and recognized ratably over the service period, generally 12-18 months, until no further obligation exists. The warranty service period starts upon product acceptance. Training and consulting service revenues that are not deemed essential to the functionality of the systems are recognized as such services are performed. Installation service revenue is recognized concurrent with system revenue.

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

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*Other revenue*

Other revenue primarily consists of research and development and construction contract revenues.

*Shared ownership program*

The Company also enters into arrangements under its shared ownership program with certain customers. Agreements under the shared ownership program typically have a term of five years, during which the customer has the option to purchase the system, either at the end of the contractual period or in advance, at the customer s request, at pre-determined prices. Under the terms of such program, the Company retains title to its system, while the customer has use of the product. The Company generally receives a minimum monthly payment and earns additional revenues from the customer based upon its use of the product. The Company may provide unspecified upgrades to the product during the term of each program when and if available. Upfront non-refundable payments and minimum monthly payments from the customer are recognized as revenue over the contractual period. Additional revenues beyond the minimum payments from the shared ownership program are recorded as they become earned and receivable and are included within shared ownership program revenues, which are included in products revenue in the condensed consolidated statements of operations.

Future minimum revenues under shared ownership arrangements as of December 31, 2011 are as follows (in thousands):

| **Year Ending June 30,** | | **Amount** |
|---|---|---|
| 2012 (remaining 6 months) | $ | 587 |
| 2013 | | 1,113 |
| 2014 | | 1,104 |
| 2015 | | 1,104 |
| 2016 | | 696 |
| Thereafter | | 560 |
| Total | $ | 5,164 |

Under the terms of the shared ownership program, the customer has the option to purchase a CyberKnife or TomoTherapy System at pre-determined prices based on the period the system has been in use and considering the lease payments already received. Revenue from such sales is recorded in accordance with the Company s revenue recognition policy, taking into account the PCS and any other elements that might be sold as part of the arrangement. At December 31, 2011, the Company had three systems installed under its shared ownership program. There were no sales of CyberKnife or TomoTherapy Systems that were formerly under the shared ownership program during the three and six months ended December 31, 2011. Product revenue of $3.6 million was recognized during the three and six months ended December 31, 2010 from the sale of one CyberKnife system that was formerly a part of the Company s shared ownership program.

The CyberKnife and TomoTherapy Systems associated with the Company s shared ownership program are recorded within property and equipment. Depreciation and warranty expenses attributable to the CyberKnife shared ownership systems are recorded within cost of products.

*Long-term construction and manufacturing contracts*

The Company recognizes revenue and cost of revenue related to long-term construction and manufacturing contracts using contract accounting on the percentage-of-completion or the completed contract method. The Company records such revenue under other revenue and cost of such revenue under cost of other in the condensed consolidated statements of operations. Any loss provision identified from the total contract in the period is recorded as an increase to cost of revenue.

**Deferred Revenue and Deferred Cost of Revenue**

Deferred revenue consists of deferred product revenue, deferred shared ownership program revenue, deferred service revenue and deferred other revenue. Deferred product revenue arises from timing differences between the shipment of product and satisfaction of all revenue recognition criteria consistent with the Company s revenue recognition policy. Deferred shared ownership program revenue results from the receipt of advance payments that will be recognized ratably over the term of the shared ownership program. Deferred service revenue results from the advance payment for services to be delivered over a period of time, usually one year. Service revenue is recognized ratably over the service period. Deferred cost of revenue consists of the direct costs associated with the manufacturing of units and direct service costs for which the revenue has been deferred in accordance with the Company s revenue recognition policies. Deferred revenue and associated deferred cost of revenue expected to be realized within one year are classified as current liabilities and current assets, respectively.

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**Goodwill and Purchased Intangible Assets**

Goodwill represents the excess of acquisition cost over the fair value of tangible and identified intangible net assets of businesses acquired. Goodwill is not amortized, but is evaluated for impairment on an annual basis or when impairment indicators are present. In the first step of the analysis, the Company s assets and liabilities, including existing goodwill and other intangible assets, are assigned to the identified reporting units to determine the carrying value of the reporting units. If the carrying value of the reporting unit is in excess of its fair value, an impairment may exist, and the Company must perform the second step of the analysis, in which the implied fair value of the goodwill is compared to its carrying value to determine the impairment charge, if any.

The fair value of the reporting unit is determined using the market approach. Under the market approach, the Company estimates the fair value of each reporting unit based on the Company s closing stock price on the trading day closest to the annual review date multiplied by the outstanding shares on that date. If the estimated fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not impaired and no further analysis is required. Through December 31, 2011, there have been no such impairment losses. Purchased intangible assets other than goodwill, including developed technology, in-process research and development, backlog and distributor license, are amortized on a straight-line basis over their estimated useful lives unless their lives are determined to be indefinite. Purchased intangible assets are carried at cost, less accumulated amortization. Amortization is computed over the estimated useful lives of the respective assets which range from approximately one to six years.

**Business Combinations**

In fiscal 2011, the Company applied ASC 805, *Business Combinations*, and accounted for the acquisition of TomoTherapy using the acquisition method of accounting. The underlying principles are similar to the previous accounting guidance and require that the Company recognize separately from goodwill the assets acquired and the liabilities assumed, generally at their acquisition date fair values. Goodwill as of the acquisition date is measured as the excess of consideration transferred and the net of the acquisition date fair values of the assets acquired and the liabilities assumed. While the Company uses its best estimates and assumptions as a part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the acquisition date, its estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, the Company may record adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill. Upon the conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments, if any, are recorded to the Company s consolidated statements of operations. Transaction costs and costs to restructure the acquired company are expensed as incurred. The operating results of the acquired company are reflected in the Company s condensed consolidated financial statements after the date of the merger or acquisition.

**Share-Based Compensation**

The Company accounts for share-based compensation by measuring and recognizing the fair value of all share-based payment awards made to employees based on the estimated grant date fair values, including employee stock options, restricted stock units ( RSUs ), restricted stock awards ( RSAs ), performance stock units ( PSUs ) and the employee stock based purchase plan ( ESPP ). The determination of fair value involves a number of significant estimates. The Company uses the Black-Scholes option pricing model to estimate the value of employee share-based awards which requires a number of assumptions to determine the model inputs. These include the expected volatility of the Company s stock, the expected term of the share-based award, the expected risk free rate of interest and dividend yields. As share-based compensation expense is based on awards ultimately expected to vest, the expense is recorded net of estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if

necessary, in subsequent periods if actual forfeitures differ from those estimates. As the Company has been operating as a public company for a period of time that is shorter than its estimated expected option term, the Company concluded that its historical price volatility does not provide a reasonable basis for input assumptions within its Black-Scholes valuation model when determining the fair value of its stock options. Expected volatility was based on the historical volatility of a peer group of publicly traded companies. The Company continues to use the simplified method for the estimated term of the awards. Management s estimate of forfeitures is based on historical experience, but actual forfeitures could differ materially as a result of voluntary employee actions which could result in a significant change in future share-based compensation expense. See Note 9, Share-Based Compensation for additional information.

**Income and Other Taxes**

The Company is required to estimate its income taxes in each of the tax jurisdictions in which it operates prior to the completion and filing of tax returns for such periods. This process involves estimating actual current tax expense together with assessing temporary differences in the treatment of items for tax purposes versus financial accounting purposes that may create net deferred tax assets and liabilities. The Company accounts for income taxes under the asset and liability method, which requires, among other things, that deferred income taxes be provided for temporary differences between the tax bases of the Company s assets and liabilities and their financial statement reported amounts. In addition, deferred tax assets are recorded for the future benefit of utilizing net operating losses, research and development credit carryforwards and temporary differences.

The Company records a valuation allowance to reduce its deferred tax assets to the amount the Company believes is more likely than not to be realized. Because of the uncertainty of the realization of the deferred tax assets, the Company has recorded a full valuation allowance against its domestic and certain foreign net deferred tax assets.

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The calculation of unrecognized tax benefits involves dealing with uncertainties in the application of complex global tax regulations. Management regularly assesses the Company s tax positions in light of legislative, bilateral tax treaty, regulatory and judicial developments in the countries in which the Company does business. As of December 31, 2011, the amount of gross unrecognized tax benefits was $14.8 million all of which would affect the Company s effective tax rate if realized. The Company recognizes interest income and interest expense and penalties on tax overpayments and underpayments within income tax expense. As of December 31, 2011, the Company had accrued a net $0.5 million payable for interest and penalties. The Company anticipates that except for $0.2 million in uncertain tax positions that may be reduced related to the lapse of various statutes of limitation, there will be no material changes in uncertain tax positions in the next 12 months.

**Net Income (Loss) Per Common Share**

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding and other dilutive common shares outstanding during the period. The potential dilutive shares of the Company s common stock resulting from the assumed exercise of outstanding stock options, the vesting of RSUs, RSAs and PSUs, and the purchase of ESPP shares are determined under the treasury stock method.

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

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| **Numerator:** | | | | |
| Net income (loss) used in computing basic and diluted net income (loss) per share | $ (10,387) | $ 4,098 | $ (36,897) | $ (542) |
| **Denominator:** | | | | |
| Weighted-average shares used in computing basic net income (loss) per share | 70,698 | 59,282 | 70,481 | 58,975 |
| Add: dilutive stock options and awards outstanding | | 2,094 | | |
| Weighted-average shares used in computing diluted net income (loss) per share | 70,698 | 61,376 | 70,481 | 58,975 |

The following table sets forth all potentially dilutive securities excluded from the computation in the table above because their effect would have been anti-dilutive (in thousands):

| | As of December 31, | |
|---|---|---|
| | 2011 | 2010 |
| Options to purchase common stock | 8,115 | 7,017 |
| Restricted stock units | 1,151 | 733 |
| Performance stock units | 954 | |

| | | |
|---|---|---|
| Restricted stock awards | 37 | |
| | 10,257 | 7,750 |

The Notes are included in the calculation of diluted net income per share if their inclusion is dilutive under the if-converted method. For the three and six months ended December 31, 2011, the potential dilutive shares under the Notes were excluded from the calculation of diluted net loss per share as their inclusion would be anti-dilutive.

**Segment Information**

The Company has determined that it operates in only one segment, as it only reports profit and loss information on an aggregate basis to its chief operating decision maker. The Company s long-lived assets maintained outside the United States are not material. Revenue by geographic region is based on the shipping addresses of the Company s customers. The following summarizes revenue by geographic region (in thousands):

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| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Americas (including Puerto Rico) | $ 54,262 | $ 38,890 | $ 103,111 | $ 61,961 |
| Europe | 25,330 | 10,575 | 53,945 | 20,525 |
| Asia (excluding Japan) | 19,715 | 3,689 | 35,872 | 7,021 |
| Japan | 7,116 | 1,092 | 13,946 | 2,807 |
| Total | $ 106,423 | $ 54,246 | $ 206,874 | $ 92,314 |

**Recent Accounting Pronouncements**

In September 2011, the FASB issued ASU 2011-08, *Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment*, applicable for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The guidance allows an entity the option to make a qualitative evaluation about the likelihood of goodwill impairment for a reporting unit. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the quantitative two-step impairment test is unnecessary. Early adoption is permitted for annual and interim goodwill impairment tests if an entity s financial statements for the most recent interim period have not yet been issued. The Company does not expect that adoption of this guidance will have a material impact on the Company s condensed consolidated financial position, results of operations and cash flows.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220) Presentation of Comprehensive Income*, to require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. The FASB issued ASU 2011-12 in December 2011 to defer certain presentation requirements of the new guidance. ASU 2011-05 is effective for the Company in the first quarter of fiscal year 2013 and should be applied retrospectively. The Company is currently evaluating the impact of its pending adoption of ASU 2011-05 on its condensed consolidated financial statements.

**3. Alliance Agreement**

In June 2010, the Company entered into a Strategic Alliance Agreement with Siemens AG, (the Agreement ), pursuant to which (1) the Company granted Siemens certain distribution rights to its CyberKnife Systems, (2) Siemens agreed to incorporate certain Accuray technology into certain of its linear accelerator ( linac ) products, the combined products being known as the Cayman Products, and (3) the Company created a research and development relationship between Accuray and Siemens for the pursuit and implementation of other potential collaboration opportunities in the future. Sales activity to date under the Agreement has not been material. Under the Agreement, both Siemens and the Company had the right to terminate the Agreement on written notice within 60 days following the acquisition of or by either party by specified competitors. On August 3, 2011, the Company entered into an Amendment to the Agreement with Siemens, which provided that each of the Company s and Siemens right to terminate the Agreement as a result of the acquisition of TomoTherapy by the Company was extended until December 31, 2011 in order to allow the Company and Siemens to evaluate the impact of the TomoTherapy acquisition on the arrangements created by the Agreement. On December 23, 2011, the Company received notice from Siemens of its termination of the Agreement effective immediately. Siemens indicated that it was terminating the Agreement, as permitted by its terms, due to Accuray s acquisition of TomoTherapy as well as to Siemens restructuring its radiation oncology business. In connection with the termination of the Agreement, on December 26, 2011, the Company and Siemens entered into an Amended and Restated Multiple Linac and Multi-Modality Distribution Agreement (the Distribution Agreement ). The Distribution Agreement was amended in order to expand Siemens distribution rights, which had previously been specific to the Company s CyberKnife Systems, to add the right to include TomoTherapy Systems in multi-product sales when it also sells its own products.

**4. Comprehensive Income (Loss)**

The components of total comprehensive income (loss) were as follows (in thousands):

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Net income (loss) | $ (10,387) | $ 4,098 | $ (36,897) | $ (542) |
| Unrealized gain (loss) on investments | | (25) | | 3 |
| Foreign currency translation adjustments | 1,532 | (46) | 2,367 | 43 |
| Total comprehensive income (loss) | $ (8,855) | $ 4,027 | $ (34,530) | $ (496) |

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Accumulated other comprehensive income at December 31, 2011 and June 30, 2011 consisted of accumulated foreign currency translation adjustments. No component of other comprehensive income at December 31, 2011 was attributable to CPAC.

**5. Balance Sheet Components**

**Accounts receivable, net**

Accounts receivable, net consists of the following (in thousands):

| | December 31, 2011 | June 30, 2011 |
|---|---|---|
| Accounts receivable | $ 72,649 | $ 59,858 |
| Unbilled fees and services | 2,929 | 2,319 |
| | 75,578 | 62,177 |
| Less: Allowance for doubtful accounts | (1,650) | (324) |
| Accounts receivable, net | $ 73,928 | $ 61,853 |

**Inventories**

Inventories consist of the following (in thousands):

| | December 31, 2011 | June 30, 2011 |
|---|---|---|
| Raw materials | $ 59,892 | $ 60,309 |
| Work-in-process | 7,317 | 10,002 |
| Finished goods | 15,672 | 27,525 |
| Total inventories | $ 82,881 | $ 97,836 |

**Property and Equipment, net**

Property and equipment consist of the following (in thousands):

| | December 31, 2011 | June 30, 2011 |
|---|---|---|
| Furniture and fixtures | $ 5,765 | $ 5,317 |

| | | | | |
|---|---|---|---|---|
| Computer and office equipment | | 8,545 | | 8,280 |
| Software | | 8,425 | | 8,107 |
| Leasehold improvements | | 15,740 | | 15,386 |
| Machinery and equipment | | 34,324 | | 33,692 |
| CyberKnife shared ownership systems | | 3,501 | | 4,923 |
| Construction in progress | | 2,517 | | 602 |
| | | 78,817 | | 76,307 |
| Less: Accumulated depreciation and amortization | | (37,992) | | (31,484) |
| Property and equipment, net | $ | 40,825 | $ | 44,823 |

Depreciation and amortization expense related to property and equipment for the three and six months ended December 31, 2011 was $4.1 million and $8.3 million, respectively. Depreciation and amortization expense related to property and equipment for the three and six months ended December 31, 2010 was $1.4 million and $2.7 million, respectively. Accumulated depreciation related to the CyberKnife systems attributable to the shared ownership program as of December 31, 2011 and June 30, 2011 was $0.9 million and $2.1 million, respectively.

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**6. Goodwill and Intangible Assets**

*Goodwill*

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

| | Six Months Ended December 31, 2011 | Year Ended June 30, 2011 |
|---|---|---|
| Balance at the beginning of the period | $ 54,474 | $ 4,495 |
| Addition related to acquisition | | 49,979 |
| Adjustments related to prior year acquisition (1) | 1,713 | |
| Balance at the end of the period | $ 56,187 | $ 54,474 |

(1) Primarily represents an additional liability incurred as part of the TomoTherapy acquisition.

*Intangible Assets*

The Company s intangible assets associated with completed acquisitions at December 31, 2011 and June 30, 2011 are as follows (in thousands):

| | | December 31, 2011 | | | June 30, 2011 | | |
|---|---|---|---|---|---|---|---|
| | Useful Lives (in years) | Gross Carrying Amount | Accumulated Amortization | Net Amount | Gross Carrying Amount | Accumulated Amortization | Net Amount |
| Developed technology | 6 | $ 43,455 | $ (5,679) | $ 37,776 | $ 43,455 | $ (2,069) | $ 41,386 |
| Backlog | 1.25 | 10,500 | (4,667) | 5,833 | 10,500 | (467) | 10,033 |
| Distributor license | 2.5 | 1,860 | (404) | 1,456 | 1,860 | (40) | 1,820 |
| In-process research and development (CPAC) | Indefinite | 12,800 | | 12,800 | 12,800 | | 12,800 |
| | | $ 68,615 | $ (10,750) | $ 57,865 | $ 68,615 | $ (2,576) | $ 66,039 |

Amortization expense related to intangible assets was $4.1 million and $0.1 million for the three months ended December 31, 2011 and 2010, respectively and $8.2 million and $0.1 million for the six months ended December 31, 2011 and 2010, respectively.

The estimated future amortization expense of purchased intangible assets, excluding in-process research and development, as of December 31, 2011 is as follows (in thousands):

| Year Ending June 30, | | Amount |
|---|---|---|
| 2012 (remaining six months) | $ | 8,046 |
| 2013 | | 9,306 |
| 2014 | | 7,298 |
| 2015 | | 6,933 |
| 2016 | | 6,934 |
| Thereafter | | 6,548 |
| | $ | 45,065 |

**7. Contingencies**

**Litigation**

From time to time, the Company is involved in legal proceedings arising in the ordinary course of its business. Currently, management believes the Company does not have any probable and estimable loss related to any current legal proceedings and claims that would individually or in the aggregate materially adversely affect its financial condition or operating results. Litigation is inherently unpredictable and is subject to significant uncertainties, some of which are beyond the Company s control. Should any of these estimates and assumptions change or prove to have been incorrect, the Company could incur significant charges related to legal matters which could have a material impact on its results of operations, financial position and cash flows.

***Accuray Securities Litigation***

On July 22, 2009, a securities class action lawsuit was filed in the U.S. District Court for the Northern District of California against the Company and certain of its current and former directors and officers. On August 7, 2009 and August 9, 2009, two securities class action complaints, both similar to the one filed on July 22, 2009, were filed against the same defendants in the same court. These three actions were consolidated. The consolidated complaint generally alleges that the Company and the individual defendants made false or misleading public statements regarding its operations and seek unspecified monetary damages and other relief. On August 31, 2010, the Court granted defendants

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motion to dismiss the consolidated complaint and granted plaintiffs leave to file an amended complaint. On September 27, 2010, plaintiffs filed an amended complaint. The amended complaint names the Company and certain of its current and former officers and directors as defendants and generally alleges that the defendants made false or misleading public statements regarding its operations. The amended complaint seeks unspecified monetary damages and other relief. Defendants filed a motion to dismiss the amended complaint. On April 28, 2011, the parties filed a stipulation of settlement with the court, providing for the settlement of the litigation for a payment of $13.5 million which will be covered by insurance. The court preliminarily approved the settlement on June 10, 2011. A hearing on the terms of the settlement was held on September 1, 2011. On December 8, 2011 the Court issued its final judgment and order of dismissal with prejudice.

***Litigation relating to the TomoTherapy Acquisition***

On March 11, 2011, a purported class action complaint was filed in the Circuit Court for the State of Wisconsin, Dane County, on behalf of a putative class of TomoTherapy shareholders and naming as defendants TomoTherapy and TomoTherapy s board of directors (prior to the acquisition of TomoTherapy by the Company). Thereafter, four additional complaints were filed in the same court on behalf of the same class and against the same defendants, and two such complaints also named the Company and Jaguar Acquisition, Inc., a wholly-owned subsidiary of the Company ( Merger Sub ). On April 4, 2011, all five actions were consolidated. The complaints generally alleged that, in connection with the Company s then proposed merger transaction with TomoTherapy, TomoTherapy s board breached their fiduciary duties by, among other things, failing to maximize the value of TomoTherapy to its shareholders and purportedly agreeing to certain terms in the merger agreement, which were allegedly preclusive and onerous. The complaints further alleged that the Company and Merger Sub aided and abetted TomoTherapy s board of directors in their alleged breaches of fiduciary duties. The plaintiffs sought, among other things, an injunction barring consummation of the merger, rescission or recessionary damages, costs and attorney s fees. The Company and Merger Sub were dismissed from the litigation without prejudice on April 19, 2011. The consolidated complaint against TomoTherapy and the former directors of TomoTherapy was dismissed with prejudice and without costs to either party on July 5, 2011.

***Best Medical Trade Secret Litigation***

On September 3, 2009, Best Medical International, Inc. ( Best Medical ) filed a lawsuit against the Company in the U.S. District Court for the Western District of Pennsylvania, claiming it induced certain individuals to leave the employment of Best Medical and join the Company in order to gain access to Best Medical s confidential information and trade secrets. Best Medical is seeking monetary damages and other relief. The Company filed a motion for summary judgment on May 20, 2011, Best Medical filed its response on June 21, 2011, and the Company filed a response to their response on July 8, 2011. On October 25, 2011, the court granted summary judgment in favor of the Company on all counts. On November 21, 2011 Best Medical filed a notice of appeal, and the parties await a ruling by the appellate court.

***Best Medical Patent Litigation***

On August 6, 2010, Best Medical filed an additional lawsuit against the Company in the U.S. District Court for the Western District of Pennsylvania, claiming it has infringed U.S. Patent No. 5,596,619 a patent that Best Medical alleges protects a method and apparatus for conformal radiation therapy. On December 2, 2010, the Court granted the Company s motion to dismiss, with leave to amend. On December 16, 2010, Best Medical filed an amended complaint, claiming that the Company also infringed U.S. Patent Nos. 6,038,283 and 7,266,175, both of which Best Medical alleges cover methods and apparatus for conformal radiation therapy. On March 9, 2011, the Court dismissed with prejudice all counts against the Company, except for two counts of alleged willful infringement of two of the patents. The Court issued a Scheduling Order on May 12, 2011 appointing a special master for claim construction, and setting a claim construction hearing on January 10, 2012. Best Medical moved to voluntarily dismiss one of the two remaining patent claims on June 28, 2011, which the court granted on June 30, 2011, leaving only

one patent (U.S. Patent No. 6,038,283) at issue in the case. On September 1, 2011, the Court modified its Scheduling Order, setting a claim construction hearing on January 24-25, 2012. On January 4, 2012, the Court again modified its Scheduling Order, changing the claim construction hearing to May 16-17, 2012. Best Medical is seeking declaratory and injunctive relief, as well as unspecified compensatory and treble damages and other relief. At this time, the Company does not have enough information to estimate what, if any, financial impact this claim will have.

***TomoTherapy Former Distributor in Japan***

On July 17, 2009, Hi-Art Co., Ltd. (Hi-Art), TomoTherapy s former distributor in Japan, filed a complaint against TomoTherapy in the Tokyo District Court seeking compensation it claimed was owed by TomoTherapy. The Company and Hi-Art entered into a settlement agreement pursuant to which the Company agreed to pay 190,000,000 yen (or approximately $2.3 million) and Hi-Art dropped all claims against TomoTherapy and the Company. On July 26, 2011, the Court approved the settlement and issued a decree dismissing the case. The settlement amount was paid during the fiscal quarter ended September 30, 2011.

***Rotary Systems***

On April 28, 2011, a former supplier to TomoTherapy, Rotary Systems Incorporated, filed suit in Minnesota state court, Tenth Judicial District, Anoka County, against TomoTherapy alleging misappropriation of trade secrets, as well as several other counts alleging various theories of injury. Rotary Systems alleges TomoTherapy misappropriated Rotary Systems trade secrets pertaining to a component previously

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purchased from Rotary Systems, which component TomoTherapy now purchases from a different supplier. The suit alleges TomoTherapy improperly supplied the alleged trade secrets to its present supplier, Dynamic Sealing Technologies Inc. (also a named defendant in the suit). Rotary Systems has made an unspecified claim for damages of greater than $50,000. TomoTherapy moved to dismiss the case in June 2011, and on August 29, 2011, the court granted the motion to dismiss with respect to all counts other than the count alleging misappropriation of trade secrets. At this time, the Company does not have enough information to estimate what, if any, financial impact this claim will have.

***Radiation Stabilization Solutions Patent Litigation***

On September 15, 2011, Radiation Stabilization Solutions LLC ( Radiation Stabilization Solutions ) filed a patent infringement complaint in the United States District Court for the Northern District of Illinois, Eastern Division. The complaint, alleged the Company s sale of our TomoHD product induces infringement of or contributorily infringes U.S. Patent No. 6,118,848, or the 848 Patent, and sought unspecified monetary damages for the alleged infringement. The complaint also named Varian Medical Systems, Inc., BrainLab AG, BrainLab, Inc., Elekta AB and Elekta, Inc. as defendants, alleging that certain of their products also infringe the 848 patent. On October 27, 2011, the Court dismissed the complaint without prejudice because non-resident defendants had been improperly named in the complaint.

On October 28, 2011, Radiation Stabilization Solutions filed a new complaint against the Company and a customer of the Company in the United States District Court for the Northern District of Illinois, Eastern Division. The new complaint repeats the original complaint s allegations against the Company and seeks unspecified monetary damages for the alleged infringement. The complaint further alleges that the customer directly and indirectly infringes the 848 patent, and seeks unspecified monetary damages for the alleged infringement. Radiation Stabilization Solutions also filed individual suits against each of Varian and Elekta and several of their respective customers. Radiation Stabilization Solutions served the complaint on Accuray and its customer on December 7, 2011. At this time, we do not have enough information to estimate what, if any, financial impact this claim will have.

**Software License Indemnity**

Under the terms of the Company s software license agreements with its customers, the Company agrees that in the event the software sold infringes upon any patent, copyright, trademark, or any other proprietary right of a third party, it will indemnify its customer licensees against any loss, expense, or liability from any damages that may be awarded against its customer. The Company includes this infringement indemnification in all of its software license agreements and selected managed services arrangements. In the event the customer cannot use the software or service due to infringement and the Company cannot obtain the right to use, replace or modify the license or service in a commercially feasible manner so that it no longer infringes, then the Company may terminate the license and provide the customer a refund of the fees paid by the customer for the infringing license or service. The Company has not recorded any liability associated with this indemnification, as it is not aware of any pending or threatened actions that represent probable losses as of December 31, 2011.

**8. Acquisition**

On June 10, 2011, the Company completed the acquisition of TomoTherapy by acquiring all of TomoTherapy s common stock in exchange for cash and shares of Accuray common stock. TomoTherapy is a creator of advanced radiation therapy solutions for cancer care. The objective of the acquisition is to create a company that can provide patients with radiation treatments tailored to their specific needs, from high-precision

radiosurgery to image-guided, intensity-modulated radiation therapy. The Company has included the financial results of TomoTherapy in its condensed consolidated financial statements from the date of acquisition.

The total purchase price for TomoTherapy was approximately $248.0 million and was comprised of the following (in thousands):

| | | |
|---|---|---|
| Cash | $ | 174,178 |
| Common stock issued (9,112,511 shares) | | 67,341 |
| Stock options assumed (1,539,255 shares) | | 2,234 |
| Restricted stock awards assumed (429,591 shares) | | 4,270 |
| | $ | 248,023 |

The unaudited pro forma results presented below include the effects of pro forma adjustments as if TomoTherapy was acquired on July 1, 2009. The nonrecurring pro forma adjustments are primarily the result of fair value adjustments to intangible assets, inventory, fixed assets and deferred revenue. The pro forma financial results do not include any anticipated synergies or other expected benefits of the acquisition. The table below is presented for informational purposes only and is not indicative of future operations or results that would have been achieved had the acquisition been completed as of July 1, 2009 (in thousands, except per share amounts).

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| | Three Months Ended December 31, 2010 | Six Months Ended December 31, 2010 |
|---|---|---|
| | (unaudited) | |
| Net revenue | $ 116,348 | $ 196,201 |
| Net loss attributable to stockholders | $ (4,104) | $ (26,422) |
| Diluted loss per share | $ (0.06) | $ (0.39) |

**9. Share-Based Compensation**

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

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Cost of revenue | $ 437 | $ 181 | $ 995 | $ 644 |
| Selling and marketing | 151 | 113 | $ 380 | 357 |
| Research and development | 567 | 620 | $ 1,169 | 1,294 |
| General and administrative | 792 | 1,041 | $ 2,012 | 2,156 |
| | $ 1,947 | $ 1,955 | $ 4,556 | $ 4,451 |

At December 31, 2011 and June 30, 2011, capitalized share-based compensation costs of $0.4 million and $0.3 million, respectively, were included as components of inventories.

*Performance-Based Awards*

During fiscal 2012, the Compensation Committee of the Board of Directors of the Company approved granting of Performance-Based Stock Units ( PSUs ) to employees of the Company which vest only upon meeting certain financial performance criteria during the performance period commencing on the first day of the Company s 2012 fiscal year and ending on the last day of the Company s 2013 fiscal year. In the event that the PSUs do not become vested as a result of the Company s performance during the performance period, all PSUs are automatically forfeited by the participants effective as of the last day of the performance period. During the six months ended December 31, 2011, approximately 1.0 million PSUs have been granted to employees valued at approximately $3.9 million which was based on the fair value of the Company s common stock on the grant date and will be recognized over the requisite performance period based on management s assessment of the probability of achieving the performance criteria. As of September 30, 2011 and December 31, 2011, management assessed that it was not probable that the performance criteria would be met during the performance period and accordingly, no compensation cost has been recognized for the PSUs during the three and six months ended December 31, 2011.

**10. Debt**

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

The Notes were issued under the Indenture between the Company and The Bank of New York Mellon Trust Company, N.A., as trustee. The Notes are convertible, as described below, at the Company s election, into common stock of the Company, cash or a combination thereof at an initial conversion rate equal to 105.5548 shares of common stock per $1,000 principal amount of the Notes, which is equivalent to a conversion price of approximately $9.47 per share of common stock, subject to adjustment. Holders of the Notes may convert their Notes at any time on or after May 1, 2016 until the close of business on the business day immediately preceding the maturity date. Prior to May 1, 2016, holders of the Notes may convert their Notes only under the following circumstances: (1) during any calendar quarter after the calendar quarter ending September 30, 2011, and only during such calendar quarter, if the closing sale price of the Company s common stock for each of 20 or more trading days in the 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the conversion price in effect on the last trading day of the immediately preceding calendar quarter; (2) during the five consecutive business days immediately after any five consecutive trading-day period (such five consecutive trading-day period, the Note Measurement Period ) in which the trading price per $1,000 principal amount of Notes for each trading day of that Note Measurement Period was equal to or less than 98% of the product of the closing sale price of shares of the Company s common stock and the applicable conversion rate for such trading day; (3) if the Company calls any or all of the Notes for redemption, at any time prior to the close of business on the business day immediately

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preceding the redemption date; or (4) upon the occurrence of specified corporate transactions as described in the Indenture.

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

On or after August 1, 2014 and prior to the maturity date, the Company may redeem for cash all or a portion of the Notes if the closing sale price of its common stock exceeds 130% of the applicable conversion price (the initial conversion price is approximately $9.47 per share of common stock) of such Notes for at least 20 trading days during any consecutive 30 trading-day period (including the last trading day of such period).

In accordance with ASC 470-20 *Debt with Conversion and Other Options*, the Company separately accounts for the liability and equity conversion components of the Notes. The principal amount of the liability component of the Notes was $75.9 million as of date of issuance, which was recognized at the present value of its cash flows using a discount rate of 10%, our approximate borrowing rate at the date of the issuance for a similar debt instrument without the conversion feature. The carrying value of the equity conversion component was $24.1 million. A portion of the initial purchaser s discount and commission and the offering costs totaling $0.9 million was allocated to the equity conversion component. The liability component will be accreted to the principal amount of the Notes using the effective interest method over five years.

The following table presents the carrying value of the Notes as of December 31, 2011 (in thousands):

| | | |
|---|---|---|
| Carrying amount of the equity conversion component | $ | 23,189 |
| | | |
| Principal amount of the Notes | $ | 100,000 |
| Unamortized debt discount (1) | | (22,532) |
| Net carrying amount | $ | 77,468 |

(1) As of December 31, 2011, the remaining period over which the unamortized debt discount will be amortized is 55 months.

A summary of interest expense and effective interest rate on the liability component related to the Notes for the three and six months ended December 31, 2011 is as follows (in thousands):

| | Three months ended December 31, 2011 | Six months ended December 31, 2011 |
|---|---|---|
| Effective interest rate | 10.0% | 10.0% |
| Interest expense related to contractual interest coupon | $ 938 | $ 1,563 |
| Interest expense related to amortization of debt discount | 959 | 1,598 |

| | | | | |
|---|---|---|---|---|
| Total interest expense recognized | $ | 1,897 | $ | 3,161 |

**11. Investment in CPAC**

During April 2008, TomoTherapy established a new affiliate, CPAC, to develop a compact proton therapy system for the treatment of cancer. CPAC s investors include TomoTherapy, private investors and potential customers.

TomoTherapy contributed intellectual property with a fair market value of approximately $1.9 million as its investment in CPAC. CPAC has raised additional capital from other investors of $22.7 million since 2008 through the sale of stock. As of December 31, 2011, the Company s ownership interest in CPAC was 5.5%. Although TomoTherapy s ownership in CPAC is less than 50%, the Company includes CPAC in its condensed consolidated financial statements because TomoTherapy is the primary beneficiary of CPAC due to its overall control of CPAC s activities and TomoTherapy s option to purchase a portion of the CPAC stock held by other CPAC investors. CPAC s outside stockholders interests are shown in the Company s condensed consolidated financial statements as Noncontrolling interest.

In December, 2010, TomoTherapy and certain other CPAC investors purchased convertible promissory notes from CPAC. Under the terms of the notes, TomoTherapy received warrants for 1,386,983 common shares of CPAC. Total consideration for the notes TomoTherapy purchased was $0.8 million. Other participating investors purchased $0.8 million of the convertible promissory notes and received warrants for an aggregate of 1,386,981 shares of CPAC. The convertible promissory notes to the other participating investors in CPAC are included in Other accrued liabilities in the Company s condensed consolidated balance sheets. The notes bear interest at 12% and are convertible into CPAC s common stock at a per share conversion price as defined in the notes. The CPAC warrants are exercisable through November 2020 at an exercise price of $0.57 per CPAC common share. At December 31, 2011, no notes had been converted and no warrants had been exercised.

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On March 9, 2011, TomoTherapy entered into a revolving promissory note with CPAC. On May 10, 2011, the revolving promissory note was amended to increase the maximum amount available to borrow to $1.9 million. As of December 31, 2011, $1.9 million was outstanding under the revolving promissory note. The revolving promissory note bears interest at 12% per annum compounded quarterly. The revolving promissory note expires and all amounts become due on the earlier of December 31, 2011, a transaction involving a change of control, or an event of default. The Company has not waived its rights to repayment of the note.

In September 2011 and October 2011, Accuray and certain other CPAC investors purchased convertible promissory notes from CPAC. Total consideration for the notes Accuray purchased was $0.4 million. The other investors purchased a total of $0.4 million of the convertible promissory notes. The convertible promissory notes held by the other investors are included in Other accrued liabilities in the Company s condensed consolidated balance sheets. The convertible promissory notes issued in September and October 2011 bear interest at 12% per annum and are convertible upon the earlier of (a) a voluntary conversion, at a conversion price agreed by CPAC and holders of notes having at least 70% of the aggregate outstanding principal balance, and (b) an automatic conversion, simultaneously with the closing of CPAC s next financing of a specified amount, at a specified per share conversion price.

In addition to the relationships described above, TomoTherapy also has a contractual agreement to provide certain accounting and back office support and management services to CPAC. Also, Accuray may provide additional financial support to CPAC in the future. Settlements of CPAC s obligations are restricted to the assets of CPAC, and creditors and beneficial interest holders of CPAC have no contractual recourse to the Company.

**12. Restructuring Charges**

In the second quarter of fiscal 2012, the Company implemented a Workforce Re-alignment Program ( WFA ) which affects approximately 51 full-time positions across the organization. The WFA was designed to position the workforce more appropriately for the Company s growth strategy and to help achieve cost synergies associated with the acquisition of TomoTherapy during fiscal 2011. The Company estimates the total restructuring-related charges associated with the WFA to be approximately $1.8 million in cash related to employee severance pay and related expenses. For the quarter ended December 31, 2011, the Company reduced its global workforce under this program by 34 full-time employees and recorded $1.5 million in charges for severance and related benefits, of which $1.1 million has been paid as of December 31, 2011. The activities comprising this WFA will be substantially completed by the end of the fourth quarter of fiscal 2012. Restructuring charges are reflected within the respective operating expenses in the condensed consolidated statements of operations.

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

*The following discussion and analysis of our financial condition as of December 31, 2011 and results of operations for the three and six months ended December 31, 2011 and 2010 should be read together with our condensed consolidated financial statements and related notes included elsewhere in this report. This discussion and analysis contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including, but not limited to statements related to: anticipated costs and timing relating to the integration of TomoTherapy; the timing for recognition of deferred service revenue; the growth of our service business as our installed base grows; the impact and timing of purchase accounting adjustments; future profitability and cash flow generation; the sufficiency of our cash resources; future capital requirements; and other statements using words such as anticipates, believes, could, estimates, expects, forecasts, intends, may, plans, projects, should, will and would, and words of similar import and the negatives thereof. Our actual results, performance or achievements could differ materially from those expressed or implied by the forward-looking statements on the basis of several factors, including those that we discuss in Risk Factors, set forth in Part I, Item 1A of our Form 10-K for the year ended June 30, 2011 and Part II, Item 1A of Form 10-Q for the quarter ended September 30, 2011, as updated in Part II, Item IA of this quarterly report on Form 10-Q. We encourage you to read those sections carefully. We urge you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report and are subject to the risks referred to above. We have based these forward-looking statements on our current expectations and projections about future events and financial trends affecting the financial condition of our business. Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by, which such performance or results will be achieved. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect any event or circumstance that arises after the date of this report.*

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

**Overview**

***Products and Markets***

We believe we are the premier radiation oncology company based on our history of rapid innovation and our leading edge technologies designed specifically to deliver radiosurgery, stereotactic body radiation therapy, intensity modulated radiation therapy, image guided radiation therapy, and adaptive radiation therapy that is tailored to the specific needs of each patient. Our suite of products includes the CyberKnife® Systems and the TomoTherapy® Systems. The systems are highly complementary offerings, serving distinct patient populations treated by the same medical specialty.

The CyberKnife Systems are robotic systems designed to deliver radiosurgery treatments to cancer tumors anywhere in the body. They are the only dedicated, full body radiosurgery systems on the market. Radiosurgery is an alternative to traditional surgery for tumors and is performed on an outpatient basis in one to five treatment sessions. It allows for the treatment of patients who otherwise would not be treated with radiation, who may not be good candidates for surgery, or who desire non-surgical treatments. The use of radiosurgery with CyberKnife Systems to treat tumors throughout the body has grown significantly in recent years, but currently represents only a small portion of the patients who develop tumors treatable with CyberKnife Systems. A determination of when it may or may not be appropriate to use a CyberKnife System for treatment is at the discretion of the treating physician and depends on the specific patient. Given, however, the CyberKnife Systems design to treat focal tumors, the CyberKnife Systems are generally not used to treat (1) very large tumors, which are considerably wider than the radiation beam that can be delivered by CyberKnife Systems, (2) diffuse, wide-spread disease, as is often the case for late stage cancers, because they are not

localized (though CyberKnife Systems might be used to treat a focal area of the disease) and (3) systemic disease, like leukemias and lymphomas, which are not localized to an organ, but rather involve cells throughout the body.

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

- Change in medical practice to utilize radiosurgery more regularly as an alternative to surgery or other treatments;

- Greater awareness among doctors and patients of the benefits of radiosurgery with the CyberKnife Systems;

- Continued evolution in clinical studies demonstrating the safety and efficacy of the use of the CyberKnife Systems to treat tumors in various parts of the body;

- Continued advances in technology which improve the quality of treatments and ease of use of the CyberKnife Systems;

- Improved access to radiosurgery with the CyberKnife Systems in various countries through regulatory approvals and / or medical insurance reimbursement rates; and

- Expansion of sales of CyberKnife Systems in countries throughout the world.

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The TomoTherapy Systems are advanced, fully integrated and versatile radiation therapy systems for the treatment of a wide range of cancer types. We began selling TomoTherapy Systems after our acquisition of TomoTherapy Incorporated on June 10, 2011. Radiation therapy is used in a variety of ways, often to treat tissue surrounding a tumor area after surgical removal of the tumor and also as the primary treatment for tumors. Radiation therapy treatments impact both cancer cells as well as healthy tissue; therefore the total prescribed radiation dose is divided into many fractions and delivered in an average of 25 to 35 treatment sessions over several weeks. Radiation therapy has been widely available and used in developed countries for decades, though many developing countries do not currently have a sufficient number of linacs to adequately treat their domestic cancer patient populations. The number of radiation therapy systems in use and sold each year is currently many times larger than the number of radiosurgery systems. Large companies, including Varian Medical Systems, Inc. and Elekta AB, generate most sales in this market. While the market for radiation therapy systems is very large and well established, growth in demand for radiation therapy system is generally considered to be lower than for radiosurgery systems. We believe the TomoTherapy Systems offer clinicians and patients significant benefits over other radiation therapy systems in the market. We believe our ability to capture more sales in this established market will be influenced by a number of factors including the following:

- Greater awareness among doctors and patients of the benefits of radiation therapy using TomoTherapy Systems;
- Advances in technology which improve the quality of treatments and ease of use of TomoTherapy Systems; and
- Expansion of TomoTherapy System sales in countries throughout the world.

***Sale of Our Products***

Generating revenue from the sale of our systems is a lengthy process. Selling our systems, from first contact with a potential customer to a complete order, generally spans six months to two years and involves personnel with multiple skills. The time from receipt of a complete order to revenue recognition is governed generally by the time required by the customer to build, renovate or prepare the treatment room for installation of the system. This time varies significantly, generally from six to twenty-four months.

In the United States, we sell to customers, including hospitals and stand-alone treatment facilities, directly through our sales organization. Outside the United States, we sell to customers in over 80 countries directly and through distributors. We have sales and service offices in France, Belgium, Germany, England, Spain, Turkey, Russia, India, Japan, Hong Kong, China and Singapore. The following table shows the number of systems installed by geographic region as of December 31, 2011:

| | |
|---|---|
| Americas | 364 |
| Europe | 130 |
| Asia (excluding Japan) | 75 |
| Japan | 47 |
| Total | 616 |

International sales of our products account for a significant and growing portion of our total revenue. Revenue derived from sales outside of the United States was $52.2 million and $103.8 million for the three and six months ended December 31, 2011 while it was $15.4 million and $30.4 million for the three and six months ended December 31, 2010, respectively. International sales as a percentage of our total revenue was 49% and 28% for the three months ended December 31, 2011 and 2010, respectively and 50% and 33% for the six months ended December 31, 2011 and 2010, respectively. The increase in international revenues during fiscal 2012 resulted from the inclusion of sales of TomoTherapy products and services in the three and six months ended December 31, 2011.

***Backlog***

Since the start of fiscal 2012 (the fiscal year beginning July 1, 2011), we have been reporting backlog in a manner that is common for all of our products.

- Products: Orders for systems, upgrades, and our shared ownership program will be reported in backlog, excluding amounts attributable to warranty service, training and installation.

- Service: Orders for service, warranty, installation, training and other recurring revenues will not be reported in backlog. Previously, orders for service were reported in backlog for CyberKnife Systems but not for TomoTherapy Systems.

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For orders that cover both products and services, only the portion of the order that is recognized as product revenue is reported as backlog. The portion of the order that is recognized as service revenue (for example, warranty service, installation and training) is not included in reported backlog. Additionally, orders for TomoTherapy Systems made on or before June 30, 2011, that met the historical TomoTherapy backlog criteria have been grandfathered into, and are included in, our backlog, with the exception of orders that would have aged out as of June 30, 2011. TomoTherapy previously did not have an age out criteria, so we have adjusted the TomoTherapy backlog to age out orders where 2.5 years have passed from the time the order entered TomoTherapy s backlog. As of December 31, 2011, product only backlog was $276.8 million in total. This amount is calculated based on the criteria set forth below and therefore is not comparable to backlog amounts previously reported for CyberKnife or TomoTherapy Systems, which were calculated using different criteria. Accordingly, we have not included, for comparison purposes, backlog amounts as of December 31, 2010 for either CyberKnife or TomoTherapy Systems, due to the changes in methodology.

Beginning with July 1, 2011, in order for the product portion of a sales agreement to be counted as backlog, it must meet the following criteria:

- The contract is signed and properly executed by both the customer and us. A customer purchase order that is signed and incorporates the terms of our contract quote will be considered equivalent to a signed and executed contract;

- The contract is non-contingent it either has cleared all its contingencies or contains no contingencies when signed;

- We have received a deposit or a letter of credit; the sale is a direct channel sale to a government entity, or the product has shipped to a customer with credit sufficient to cover the deposit;

- The specific end customer site has been identified by the customer in the written contract or written amendment; and

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

Although our backlog includes only contractual agreements from our customers to purchase CyberKnife Systems or TomoTherapy Systems, we cannot make assurances that we will convert backlog into recognized revenue due to factors outside our control including without limitation, changes in customers needs, changes in reimbursement, changes to regulatory requirements, or other cancellation of orders.

**Material Weakness in Internal Control Over Financial Reporting**

In connection with our evaluation of internal control over financial reporting for the fiscal year ended June 30, 2011, we identified a material weakness relating to our accounting for significant, non-routine transactions. During the three and six months ended December 31, 2011, our efforts to remediate the previously reported material weakness in internal control over financial reporting consisted of the following corrective

actions:

- We hired several finance personnel and are continuing to recruit for several positions within the finance function, which will provide us with the appropriate resources and technical skills to ensure that the period-end financial close and reporting processes are completed in an adequate and reliable manner.

- We implemented a practice, pursuant to which we consulted with, and will continue to consult with external subject matter experts as necessary to address any significant, non-routine transactions that may arise in order to validate the accounting approach prior to execution.

Although we have taken measures to remediate the previously reported material weakness mentioned above, as well as other significant deficiencies and control deficiencies, we cannot assure you that we have identified all, or that we will not in the future have additional material weaknesses, significant deficiencies and control deficiencies.

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**Results of Operations**

***Three and Six Months Ended December 31, 2011 Compared to Three and Six Months Ended December 31, 2010***

**Net Revenue**

| (Dollars in thousands) | Three Months Ended December 31, 2011 | 2010 | Variance | Variance in Percent | Six Months Ended December 31, 2011 | 2010 | Variance | Variance in Percent |
|---|---|---|---|---|---|---|---|---|
| Products | $ 63,802 | $ 35,271 | $ 28,531 | 81% | $ 119,976 | $ 55,187 | $ 64,789 | 117% |
| Services | 42,097 | 18,846 | 23,251 | 123% | 85,498 | 36,580 | 48,918 | 134% |
| Other | 524 | 129 | 395 | 306% | 1,400 | 547 | 853 | 156% |
| Net Revenue | $ 106,423 | $ 54,246 | $ 52,177 | 96% | $ 206,874 | $ 92,314 | $ 114,560 | 124% |

Total net revenue for the three months ended December 31, 2011 increased by $52.2 million from the three months ended December 31, 2010 to $106.4 million. This increase was due to the addition of $59.0 million of revenue related to our TomoTherapy Systems, less a decline of $6.8 million in revenue related to our CyberKnife Systems due to one less unit sold during the three months ended December 31, 2011 as compared to the three months ended December 31, 2010 and lower revenue per system due to unfavorable exchange rates in certain geographies where our products are sold.

The increase in product revenue for the three months ended December 31, 2011 as compared to the comparable period in 2010 was due to $37.1 million related to TomoTherapy Systems, less a decline of $8.6 million related to CyberKnife Systems. The increase in service revenue for the three months ended December 31, 2011 as compared to the comparable period in 2010 was due to $21.4 million related to TomoTherapy service revenue and an increase of $1.8 million related to CyberKnife service revenue.

We acquired TomoTherapy on June 10, 2011, therefore our results for the three and six month period ended December 31, 2010 did not include any revenues or cost of revenues related to TomoTherapy Systems. In accordance with purchase accounting standards, a number of adjustments were recorded to the value of assets and liabilities of TomoTherapy as of the closing of the acquisition on June 10, 2011. During the three and six month periods ended December 31, 2011, $3.7 million and $8.8 million, respectively, of the write-up of deferred service revenue was recognized as service revenue. We anticipate the balance of this write-up will be recognized as service revenue through the fourth quarter of fiscal 2012.

We expect our service revenue to increase as our installed base continues to grow.

Total net revenue for the six months ended December 31, 2011 increased by $114.6 million from the six months ended December 31, 2010 to $206.9 million due to the addition of $128.3 million of revenue related to our TomoTherapy Systems, less a decline of $13.7 million in revenue related to our CyberKnife Systems due to one less unit sold during the six months ended December 31, 2011 as compared to the six months ended December 31, 2010, lower revenue per system due to changes in the mix of products sold, and unfavorable exchange rates in certain

geographies where our products are sold, partially offset by increases in service revenues due to increases in the installed base.

The increase in product revenue for the six months ended December 31, 2011 as compared to the comparable period in 2010 was due to $82.0 million related to TomoTherapy Systems, less a decline of $17.2 million related to CyberKnife Systems. The increase in service revenue for the six months ended December 31, 2011 as compared to the comparable period in 2010 was due to $45.1 million related to TomoTherapy service revenue and an increase of $3.8 million related to CyberKnife service revenue.

**Gross Profit**

| | Three Months Ended December 31, | | | | Six Months Ended December 31, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2011 | | 2010 | | 2011 | | 2010 | |
| | (Dollars in thousands) | (% of net revenue) | (Dollars in thousands) | (% of net revenue) | (Dollars in thousands) | (% of net revenue) | (Dollars in thousands) | (% of net revenue) |
| Gross profit | $ 40,243 | 37.8% | $ 29,466 | 54.3% | $ 64,671 | 31.3% | $ 47,703 | 51.7% |
| Products | $ 31,002 | 48.6% | $ 22,015 | 62.4% | $ 48,803 | 40.7% | $ 34,434 | 62.4% |
| Services | $ 8,920 | 21.2% | $ 7,466 | 39.6% | $ 14,972 | 17.5% | $ 13,400 | 36.6% |
| Other | $ 321 | 61.3% | $ (15) | -11.6% | $ 896 | 64.0% | $ (131) | -23.9% |

Our gross profit margin for the three months ended December 31, 2011 was 16.5 percentage points lower than during the three months ended December 31, 2010. This decline was due principally to the lower gross profit margin of 26.0% on TomoTherapy revenues included in our results of operations for the three months ended December 31, 2011. In addition, the gross profit margin on CyberKnife revenues declined slightly by 1.8 percentage points primarily due to unfavorable exchange rates which was partially offset by higher margins on service revenues.

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Our gross profit margin for the six months ended December 31, 2011 was 20.4 percentage points lower than during the six months ended December 31, 2010. This decline was due principally to the lower gross profit margin of 21.1% on TomoTherapy revenues included in our results of operations for the six months ended December 31, 2011. In addition, the gross profit margin on CyberKnife revenues declined by 3.9 percentage points primarily due to changes in product mix and unfavorable exchange rates, partially offset by higher margins on service revenues.

In accordance with purchase accounting standards, a number of adjustments were recorded to the value of assets and liabilities of TomoTherapy as of the closing of the acquisition on June 10, 2011. These included the write-up of inventory based on selling price rather than cost of manufacturing, the write-down of deferred product revenue, the write-up of deferred service revenue, and the recording of intangible assets related to developed technology and to backlog existing at the time of the acquisition. On the acquisition date, deferred service and product revenues were valued at cost plus a reasonable margin. Including the results of these and other purchase accounting adjustments, the results from the sale of TomoTherapy services for the six month period ended December 31, 2011 reflect a negative gross margin. Also, the results from the sale of TomoTherapy products were negatively impacted by these purchase accounting adjustments during the same period. During the three and six month periods ended December 31, 2011, product revenues were reduced by $0.1 million and $0.5 million, respectively, while product cost of revenues were increased by $4.5 million and $16.0 million, respectively. Services revenues were increased by $3.7 million and $8.8 million for the three and six month periods ended December 31, 2011, respectively, while services cost of revenues were decreased by $1.1 million during the three month period ended December 31, 2011 and increased by $1.4 million during the six month period ended December 31, 2011. We expect that the impact of the purchase accounting adjustments to inventory and deferred revenues will flow through our statement of operations from the date of the acquisition through the fourth quarter of fiscal 2012.

**Selling and Marketing**

| | Three Months Ended December 31, | | | | Six Months Ended December 31, | | | |
|---|---|---|---|---|---|---|---|---|
| **(Dollars in thousands)** | **2011** | **2010** | **Variance** | **Variance in Percent** | **2011** | **2010** | **Variance** | **Variance in Percent** |
| Selling and marketing | $ 14,017 | $ 7,987 | $ 6,030 | 75% | $ 27,598 | $ 15,747 | $ 11,851 | 75% |
| *Percentage of net revenue* | *13.2%* | *14.7%* | | | *13.3%* | *17.1%* | | |

Selling and marketing expenses for the three months ended December 31, 2011 increased $6.0 million compared to the three months ended December 31, 2010. The increase was attributable primarily to higher employee related expenses and sales commissions of $3.8 million due to headcount increases, tradeshows expense of $0.8 million, travel expense of $0.7 million and office facilities and communications related expenses of $0.5 million. During the three months ended December 31, 2011, we incurred $4.5 million of selling and marketing expenses from our TomoTherapy subsidiary consisting primarily of employee related expenses and sales commissions of $3.0 million, travel expense of $0.7 million and tradeshows expense of $0.3 million.

Selling and marketing expenses for the six months ended December 31, 2011 increased $11.9 million compared to the six months ended December 31, 2010. The increase was primarily attributable to higher employee related expenses and sales commissions of $7.0 million, travel expense of $1.7 million, tradeshows expense of $1.1 million, office facilities and communication related expenses of $0.9 million and consulting fees of $0.7 million. During the six months ended December 31, 2011, we incurred $9.3 million of selling and marketing expenses from our TomoTherapy subsidiary consisting primarily of employee related expenses and sales commissions of $6.4 million, travel expense of $1.4 million and tradeshows expense of $0.6 million.

**Research and Development**

| (Dollars in thousands) | Three Months Ended December 31, 2011 | 2010 | Variance | Variance in Percent | Six Months Ended December 31, 2011 | 2010 | Variance | Variance in Percent |
|---|---|---|---|---|---|---|---|---|
| Research and development | $ 19,874 | $ 9,313 | $ 10,561 | 113% | $ 40,439 | $ 17,360 | $ 23,079 | 133% |
| *Percentage of net revenue* | *18.7%* | *17.2%* | | | *19.5%* | *18.8%* | | |

Research and development expenses for the three months ended December 31, 2011 increased $10.6 million compared to the three months ended December 31, 2010. The increase was primarily attributable to $6.2 million in higher employee related expense from increased headcount, $2.1 million in higher spending for non-employee project costs and consulting expenses and $2.1 million in higher office facilities and communications related expenses. During the three months ended December 31, 2011, we incurred $9.2 million of research and development expenses from our TomoTherapy subsidiary consisting primarily of employee related expenses of $5.2 million and non-employee project costs and consulting expenses of $1.8 million.

Research and development expenses for the six months ended December 31, 2011 increased $23.1 million compared to the six months ended December 31, 2010. The increase was primarily attributable to $13.4 million in higher employee related expenses, $5.1 million in higher spending for non-employee project costs and consulting expenses and $3.4 million in office and communication related expenses. During the six months ended December 31, 2011, we incurred $19.4 million of research and development expenses from our TomoTherapy subsidiary consisting primarily of employee related expenses of $11.1 million and non-employee project costs and consulting expenses of $3.7 million.

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**General and Administrative**

| (Dollars in thousands) | Three Months Ended December 31, 2011 | 2010 | Variance | Variance in Percent | Six Months Ended December 31, 2011 | 2010 | Variance | Variance in Percent |
|---|---|---|---|---|---|---|---|---|
| General and administrative | $ 13,663 | $ 8,481 | $ 5,182 | 61% | $ 28,632 | $ 17,040 | $ 11,592 | 68% |
| *Percentage of net revenue* | *12.8%* | *15.6%* | | | *13.8%* | *18.5%* | | |

General and administrative expenses for the three months ended December 31, 2011 increased $5.2 million compared to the three months ended December 31, 2010. The increase was primarily attributable to higher consulting, accounting and legal fees of $2.3 million, higher employee related expenses of $1.7 million due to increased headcount and costs associated with the TomoTherapy integration and higher office facilities and communications related expenses of $0.9 million. During the three months ended December 31, 2011, we incurred $2.7 million of general and administrative expenses from our TomoTherapy subsidiary consisting primarily of employee related expenses of $1.4 million and consulting, accounting and legal fees of $1.0 million.

General and administrative expenses for the six months ended December 31, 2011 increased $11.6 million compared to the six months ended December 31, 2010. The increase was primarily attributable to increased consulting, accounting and legal fees of $6.1 million, higher employee related costs of $3.9 million from higher headcount and higher office and communications related expenses of $0.9 million. During the six months ended December 31, 2011, we incurred $5.2 million of general and administrative expenses from our TomoTherapy subsidiary consisting of employee related expenses of $3.2 million and consulting, accounting and legal fees of $1.6 million.

**Other Income (Expense), Net**

| (Dollars in thousands) | Three Months Ended December 31, 2011 | 2010 | Variance | Variance in Percent | Six Months Ended December 31, 2011 | 2010 | Variance | Variance in Percent |
|---|---|---|---|---|---|---|---|---|
| Other income (expense), net | $ (4,513) | $ 676 | $ (5,189) | -768% | $ (7,371) | $ 2,292 | $ (9,663) | -422% |
| *Percentage of net revenue* | *-4.2%* | *1.2%* | | | *-3.6%* | *2.5%* | | |

Other income (expense), net, was a $4.5 million expense for the three months ended December 31, 2011 compared to net other income of $0.7 million for the three months ended December 31, 2010. During the three months ended December 31, 2011, we incurred interest expense of $2.0 million related to our 3.75% Convertible Senior Notes due August 1, 2016 (the Notes ), which were issued in August 2011. We incurred foreign currency transaction losses of $2.1 million during the three months ended December 31, 2011 while we recorded a gain of $0.5 million from foreign currency transaction gains during the three months ended December 31, 2010.

Other income (expense), net, was a $7.4 million expense for the six months ended December 31, 2011 compared to net other income of $2.3 million for the six months ended December 31, 2010. During the six months ended December 31, 2011, we incurred interest expense of $3.4 million related to the Notes and a foreign currency loss of $3.6 million. During the three months ended December 31, 2010, our other income,

net, consisted primarily of $2.0 million related to foreign currency transaction gains.

**Provision for Incomes Taxes**

| (Dollars in thousands) | Three Months Ended December 31, 2011 | 2010 | Variance | Variance in Percent | Six Months Ended December 31, 2011 | 2010 | Variance | Variance in Percent |
|---|---|---|---|---|---|---|---|---|
| Provision for income taxes | $ 367 | $ 263 | $ 104 | 40% | $ 905 | $ 390 | $ 515 | 132% |
| *Percentage of net revenue* | *0.3%* | *0.5%* | | | *0.4%* | *0.4%* | | |

On a quarterly basis, we provide for income taxes based upon an estimated annual effective income tax rate. For the three and six months ended December 31, 2011 we recorded income tax expense of $0.4 million and $0.9 million, respectively while for the three and six months ended December 31, 2010, we recorded income tax expense of $0.3 million and $0.4 million respectively. The increases during the three and six months ended December 31, 2011 are primarily related to increases in corporate earnings of our foreign subsidiaries.

**Liquidity and Capital Resources**

At December 31, 2011, we had $148.5 million in cash and cash equivalents. We expect to use cash for the balance of fiscal 2012 driven primarily by operating losses and capital expenditures. We anticipate that we will begin to turn profitable and generate positive cash flow in the later part of fiscal 2013. Cash from operations could be affected by various risks and uncertainties, including, but not limited to the risks included in Part II, Item 1A of our Form 10-Q for the quarter ended September 30, 2011 as updated in Part II, Item 1A titled Risk Factors of this Form 10-Q. However, based on our current business plan and revenue prospects, we believe that we will have sufficient cash resources and anticipated cash flows to continue operations for at least the next 12 months.

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**Cash Flows From Operating Activities**

Net cash used in operating activities was $38.4 million for the six months ended December 31, 2011 which was attributable to net loss of $40.3 million, $25.2 million of non-cash charges and cash used for working capital purposes of $23.3 million. Non-cash charges primarily included $16.5 million of depreciation and amortization expenses, $4.6 million of share-based compensation expense, accretion of interest expense on the Notes of $1.6 million, $1.3 million for provision for bad debts and $1.0 million for provision for write-down of inventories. Cash used for working capital was primarily attributed to increases in account receivable of $15.0 million due to higher billings, decreases in accounts payable of $17.0 million due to timing of vendor payments and decreases in accrued liabilities of $23.8 million due to payments for acquisition related, value-added tax related, and other liabilities, and partially offset by cash flow from decreases in inventory balances of $12.1 million due to usage and increases in deferred revenues of $17.2 million due to increased shipments and billings.

Net cash provided by operating activities was $0.2 million for the six months ended December 31, 2010. Our net loss of $0.5 million contributed to the negative cash flows from working capital changes including a decrease in deferred revenue, net of deferred cost of revenue of $3.6 million, an increase in inventories of $8.8 million and a decrease in accounts payable of $4.0 million. This was offset primarily by a decrease in accounts receivable of $8.5 million. The decrease in deferred revenue, net of deferred cost of revenue, was primarily a result of the recognition of revenue previously deferred for systems sold under our Platinum plan and timing differences between invoicing customers for products and services and the recognition of the invoicing as revenue. Increases in inventory were due to increases in production while the decrease in accounts payable was due to timing differences between the receipt of goods and service and vendor payments. Non-cash charges included $4.5 million of stock-based compensation charges, $2.9 million of depreciation and amortization expense, and write-down of inventories of $0.7 million.

**Cash Flows From Investing Activities**

Net cash used in investing activities was $5.3 million for the six months ended December 31, 2011, which consisted of purchases of property and equipment of $3.9 million and $1.4 million related to the acquisition of TomoTherapy.

Net cash provided by investing activities was $60 thousand for the six months ended December 31, 2010, which was primarily attributable to net marketable securities activities of $3.3 million, which consisted of $74.9 million of sales and maturities of marketable securities, offset by $71.6 million in purchases, and $3.3 million of cash used for purchases of property and equipment.

**Cash Flows From Financing Activities**

Net cash provided by financing activities was $98.1 million for the six months ended December 31, 2011. In August 2011, we issued the Notes for net proceeds of $96.1 million. In addition, we received $2.0 million attributable to proceeds from the exercise of common stock options and the purchase of common stock under our employee stock plans.

Net cash provided by financing activities of $3.5 million for the six months ended December 31, 2010 was attributable to proceeds from the exercise of common stock options and the purchase of common stock under our employee stock plans.

*Convertible Debt*

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

The Notes were issued under the Indenture between us and The Bank of New York Mellon Trust Company, N.A., as trustee. The Notes are convertible, as described below, at our election, into our common stock, cash or a combination thereof at an initial conversion rate equal to 105.5548 shares of common stock per $1,000 principal amount of the Notes, which is equivalent to a conversion price of approximately $9.47 per share of common stock, subject to adjustment. Holders of the Notes may convert their Notes at any time on or after May 1, 2016 until the close of business on the business day immediately preceding the maturity date. Prior to May 1, 2016, holders of the Notes may convert their Notes only under the following circumstances: (1) during any calendar quarter after the calendar quarter ending September 30, 2011, and only during such calendar quarter, if the closing sale price of our common stock for each of 20 or more trading days in the 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the conversion price in effect on the last trading day of the immediately preceding calendar quarter; (2) during the five consecutive business days immediately after any five consecutive trading-day period (such five consecutive trading-day period, the Note Measurement Period ) in which the trading price per $1,000 principal amount of Notes for each trading day of that Note Measurement Period was equal to or less than 98% of the product of the closing sale price of

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shares of our common stock and the applicable conversion rate for such trading day; (3) if we call any or all of the Notes for redemption, at any time prior to the close of business on the business day immediately preceding the redemption date; or (4) upon the occurrence of specified corporate transactions as described in the Indenture.

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

On or after August 1, 2014 and prior to the maturity date, we may redeem for cash all or a portion of the Notes if the closing sale price of our common stock exceeds 130% of the applicable conversion price (the initial conversion price is approximately $9.47 per share of common stock) of such Notes for at least 20 trading days during any consecutive 30 trading-day period (including the last trading day of such period).

In accordance with ASC 470-20 *Debt with Conversion and Other Options*, we separately account for the liability and equity conversion components of the Notes. The principal amount of the liability component of the Notes was $75.9 million as of date of issuance, which was recognized at the present value of its cash flows using a discount rate of 10%, our approximate borrowing rate at the date of the issuance for a similar debt instrument without the conversion feature. The carrying value of the equity conversion component was $24.1 million. A portion of the initial purchaser s discount and commission and the offering costs totaling $0.9 million was allocated to the equity conversion component. The liability component will be accreted to the principal amount of the Notes using the effective interest method over five years.

**Operating Capital and Capital Expenditure Requirements**

Our future capital requirements depend on numerous factors. These factors include but are not limited to the following:

- Revenue generated by sales of our products, our shared ownership program and service plans;
- Costs associated with our sales and marketing initiatives and manufacturing activities;
- Facilities, equipment and IT systems required to support current and future operations;
- Rate of progress and cost of our research and development activities;

- Costs of obtaining and maintaining FDA and other regulatory clearances of our products;

- Effects of competing technological and market developments;

- Number and timing of acquisitions and other strategic transactions; and

- Costs associated with the integration of TomoTherapy.

If our cash and cash equivalents are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or debt securities or obtain additional credit facilities. The sale of additional equity or convertible debt securities could result in dilution to our stockholders. If additional funds are raised through the issuance of debt securities, these securities could have rights senior to those associated with our common stock and could contain covenants that would restrict our operations. Additional financing may not be available at all, or in amounts or on terms acceptable to us. If we are unable to obtain this additional financing, we may be required to reduce the scope of our planned product development and marketing efforts.

**Contractual Obligations and Commitments**

We presented our contractual obligations in our Annual Report on Form 10-K for the previous annual reporting period ended June 30, 2011. There have been no material changes outside of the ordinary course of business in those obligations during the current quarter.

**Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements.

**Critical Accounting Policies and Estimates**

The discussion and analysis of our financial condition and results of operations is based on our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ).

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The preparation of these condensed consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, as well as revenue and expenses during the reporting periods. We evaluate our estimates and judgments on an ongoing basis. We base our estimates on historical experience and on various other factors we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities. Actual results could therefore differ materially from those estimates if actual conditions differ from our assumptions.

All of our significant accounting policies and methods used in the preparation of our condensed consolidated financial statements are described in Note 2, Summary of Significant Accounting Policies , in notes to the condensed consolidated financial statements. During the three and six months ended December 31, 2011, there have been no changes to the critical accounting policies and estimates as discussed in Part II, Item 7 of our 2011 Annual Report on Form 10-K for the year ended June 30, 2011, which we believe are those related to revenue recognition, business combinations and intangible asset impairment, inventories, share-based compensation expense, income taxes, loss contingencies and corporate bonus expense and accruals.

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

***Foreign Currency Exchange Rate Risk***

As of December 31, 2011, there were immaterial amounts in deferred revenue for CyberKnife and TomoTherapy System contracts denominated in a foreign currency, in which system revenue would be recognized in future periods. Future fluctuations in the value of the U.S. dollar may affect the price competitiveness of our products outside the United States. For direct sales outside the United States, we sell in both U.S. dollars and local currencies, which could expose us to additional foreign currency risks, including changes in currency exchange rates. Our operating expenses in countries outside the United States, including some of our commissions related to sales of the CyberKnife and TomoTherapy Systems, are payable in foreign currencies and therefore expose us to currency risk. To the extent that management can predict the timing of payments under sales contracts or for operating expenses that are denominated in foreign currencies, we may engage in hedging transactions to mitigate such risks in the future.

***Interest Rate Risk***

At December 31, 2011, we had $148.5 million of cash and cash equivalents. Our earnings are affected by changes in interest rates due to the impact those changes have on interest income generated from our cash balances. We believe that, while the instruments we hold are subject to changes in the financial standing of the issuer of such securities, at December 31, 2011, we were not subject to significant levels of interest rate risk as a small amount of our cash was invested in money market funds.

***Equity Price Risk***

On August 1, 2011, we issued $100 million aggregate principal amount of the Notes. Upon conversion, we can settle the obligation by issuing our common stock, cash or a combination thereof at an initial conversion rate equal to 105.5548 shares of common stock per $1,000 principal amount of the Notes, which is equivalent to a conversion price of approximately $9.47 per share of common stock, subject to adjustment. There is no equity price risk if the share price of our common stock is below $9.47 upon conversion of the Notes. For every $1 that the share price of our common stock exceeds $9.47, we expect to issue an additional $10.6 million in cash or shares of our common stock, or a combination thereof, if all of the Notes are converted.

**Item 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow for timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2011. Based on this evaluation, and because of the continuing material weakness described below, our Chief Executive Officer and Chief Financial Officer concluded that as of December 31, 2011 our disclosure controls and procedures were not effective to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Notwithstanding the material weakness described above, we have performed additional analyses and other procedures to enable management to conclude that our condensed consolidated financial statements included in this report were prepared in accordance with accounting principles generally accepted in the United States of America.

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**Internal Control over Financial Reporting**

*Previously Reported Material Weakness*

As described herein, and as previously reported in our Annual Report on Form 10-K for the fiscal year ended June 30, 2011, in connection with the audit of our consolidated financial statements for the year ended June 30, 2011 we identified a material weakness in our internal control over financial reporting related to accounting for significant, non-routine transactions.

Specifically, we did not have sufficient numbers of highly skilled accountants to provide for a timely analysis, documentation and review of the acquisition of TomoTherapy which closed on June 10, 2011. During the three and six months ended December 31, 2011, our efforts to remediate this continuing material weakness in our internal control over financial reporting consisted of the following corrective actions:

- We hired several finance personnel and continuing to recruit for several positions within the finance function which will provide us with the appropriate resources and technical skills to ensure that the period-end financial close and reporting processes are completed in an adequate and reliable manner.

- We implemented a practice, pursuant to which we consulted with, and will continue to consult with external subject matter experts as necessary to address any significant, non-routine transactions that may arise in order to validate the accounting approach prior to execution.

*Changes in Internal Control Over Financial Reporting*

During the three months ended December 31, 2011, except as described above, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

*Inherent Limitations of Internal Control Over Financial Reporting*

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and in reaching a reasonable level of assurance, management is

required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

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**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings.**

Please refer to Note 7 to the Condensed Consolidated Financial Statements above for a description of certain legal proceedings currently pending against the Company. From time to time we are involved in legal proceedings arising in the ordinary course of our business.

**Item 1A. Risk Factors.**

A description of the risk factors associated with our business is included under Risk Factors contained in Part I, Item 1A of our Form 10-K for the year ended June 30, 2011 and in Part II, Item 1A. of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 and is incorporated herein by reference. Other than the items discussed below, there have been no material changes in our risk factors since such filing.

***The distribution arrangements between Accuray and Siemens AG may not be successful.***

In June 2010, we entered into a Strategic Alliance Agreement with Siemens AG, or the Alliance Agreement, pursuant to which (1) we granted Siemens certain distribution rights to our CyberKnife Systems, (2) Siemens agreed to incorporate certain Accuray technology into certain of its linac products, the combined products being known as the Cayman Products, and (3) we created a research and development relationship between Accuray and Siemens for the pursuit and implementation of other potential collaboration opportunities in the future. Sales activity to date under the Agreement has not been material. Siemens terminated the Alliance Agreement effective December 23, 2011, thereby terminating the elements of the Alliance Agreement described in clauses (2) and (3) above. Simultaneously with the termination of the Alliance Agreement, Siemens and the Company entered into an Amended and Restated MultiModality and Multiple Linac Distribution Agreement, pursuant to which Siemens may distribute both CyberKnife and TomoTherapy Systems.

There can be no assurance that the distribution arrangements with Siemens AG will be successful. We are not able to control the amount and timing of resources that Siemens will devote to the distribution of CyberKnife or TomoTherapy Systems. Failure of Siemens to distribute the CyberKnife or TomoTherapy Systems could negatively impact our stock price and our future business and financial results.

***If we fail to maintain an effective system of internal control over financial reporting, we may not be able to accurately report our financial results. As a result, current and potential stockholders could lose confidence in our financial reporting, which could have an adverse effect on our business and our stock price.***

Effective internal controls are necessary for us to provide reliable financial reports and to protect from fraudulent, illegal or unauthorized transactions. If we cannot provide effective controls and reliable financial reports, our business and operating results could be harmed. Our

management determined, as of June 30, 2011, that we had a material weakness in our internal control over financial reporting, and they have further concluded that our disclosure controls and procedures were not effective as of December 31, 2011 due to such material weakness, which has not yet been fully remediated. Our remediation efforts during the first and second quarter of fiscal 2012 include (1) hiring several finance personnel and continuing to recruit for several positions within the finance function, which will provide us with the appropriate resources and technical skills to ensure that the period-end financial close and reporting processes are completed in an adequate and reliable manner, and (2) implementing a practice, pursuant to which we consulted with, and will continue to consult with external subject matter experts as necessary to address any significant, non-routine transactions that may arise in order to validate the accounting approach prior to execution.

A failure to implement and maintain effective internal control over financial reporting, including a failure to implement corrective actions to address the control deficiencies identified above, could result in a material misstatement of our financial statements or otherwise cause us to fail to meet our financial reporting obligations. This, in turn, could result in a loss of investor confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our business and operating results and our stock price, and we could be subject to stockholder litigation. In addition, remedying this material weakness may require significant additional financial and managerial resources

***We may have difficulties in determining the effectiveness of our internal controls due to our complex financial model.***

The complexity of our financial model contributes to our need for effective financial reporting systems and internal controls. We recognize revenue from a range of transactions including CyberKnife and TomoTherapy System sales, our shared ownership program and services. The CyberKnife and TomoTherapy Systems are complex products that contain both hardware and software elements. The complexity of the CyberKnife and TomoTherapy Systems and of our financial model pertaining to revenue recognition requires us to process a broader range of financial transactions than would be required by a company with a less complex financial model. Accordingly, deficiencies or weaknesses in our internal controls would likely impact us more significantly than they would impact a company with a less complex financial model. If we were to find that our internal controls were deficient, we could be required to amend or restate historical or pro forma financial statements, which would likely have a negative impact on our stock price. Our management determined, as of June 30, 2011, that we had a material weakness in our internal control over financial reporting, and they have further concluded that our disclosure controls and procedures were not effective as of December 31, 2011 due to such material weakness, which has not yet been fully remediated. We began our remediation efforts during the first and second quarters of fiscal 2012.

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***We face risks related to the current global economic environment, which could delay or prevent our customers from obtaining financing to purchase the CyberKnife and TomoTherapy Systems and implement the required facilities, which would adversely affect our business, financial condition and results of operations.***

The state of the global economy continues to be uncertain. The current global economic conditions and uncertain credit markets and concerns regarding the availability of credit pose a risk that could impact consumer and customer demand for our products, as well as our ability to manage normal commercial relationships with our customers, suppliers and creditors, including financial institutions. If the current situation continues to deteriorate or does not improve, our business could be negatively affected, including such areas as reduced demand for our products resulting from a slow-down in the general economy, supplier or customer disruptions and/or temporary interruptions in our ability to conduct day-to-day transactions through our financial intermediaries involving the payment to or collection of funds from our customers, vendors and suppliers. For example, in the United States, some of our customers have been delayed in obtaining, or have not been able to obtain, necessary financing for their purchases of the CyberKnife or TomoTherapy Systems. In addition, some of our customers have been delayed in obtaining, or have not been able to obtain, necessary financing for the construction or renovation of facilities to house CyberKnife or TomoTherapy Systems, the cost of which typically range from approximately $0.3 million for a TomoTherapy System and $0.5 million for a CyberKnife System, for customers who make only minor renovations to existing facilities, to up to $2 million for a TomoTherapy System and $2.5 million for a CyberKnife System, for customers who build entirely new facilities that include additional features not necessarily required for the operation of a TomoTherapy or CyberKnife System (e.g., audio visual equipment). This range is based solely on information provided to us by customers and will vary by geography and the needs of a particular customer. To date, these delays have primarily affected customers that were planning to operate freestanding CyberKnife or TomoTherapy Systems centers, rather than hospital-based customers. These delays have in some instances led to our customers postponing the shipment and installation of previously ordered systems or cancelling their system orders, and may cause other customers to postpone their system installation or to cancel their agreements with us. An increase in delays and order cancellations of this nature would adversely affect our product sales, backlog and revenues, and therefore harm our business and results of operations.

***If we are found to have violated laws protecting the confidentiality of patient health information, we could be subject to civil or criminal penalties, which could increase our liabilities and harm our reputation or our business.***

There are a number of federal and state laws protecting the confidentiality of certain patient health information, including patient records, and restricting the use and disclosure of that protected information. In particular, the U.S. Department of Health and Human Services has promulgated patient privacy rules under the Health Insurance Portability and Accountability Act of 1996, or HIPAA. These privacy rules protect medical records and other personal health information of patients by limiting their use and disclosure, giving patients the right to access, amend and seek accounting of their own health information and limiting most uses and disclosures of health information to the minimum amount reasonably necessary to accomplish the intended purpose. Although we are not a covered entity under HIPAA, we have entered into agreements with certain covered entities under which we are considered to be a business associate under HIPAA. As a business associate, we are required to implement policies, procedures and reasonable and appropriate physical, technical and administrative security measures to protect individually identifiable health information we receive from covered entities. Our failure to protect health information received from customers could subject us to liability to both the government and the covered entity, adverse publicity, and could harm our business and impair our ability to attract new customers.

The HIPAA privacy standard was amended by the Health Information Technology for Economic and Clinical Health Act (HITECH), enacted as part of the American Recovery and Reinvestment Act of 2009. HITECH significantly increases the civil money penalties for violations of patient privacy rights protected under HIPAA. Furthermore, as of February 2010, Business Associates who have access to patient health information provided by hospitals and healthcare providers are now directly subject to HIPAA, including a new enforcement scheme and inspection requirements.

Moreover, we manufacture and sell products that allow our customers to store confidential information about their patients. While we have implemented security measures to protect our products from unauthorized access, these measures do not secure our customers equipment or any information stored in our customers systems or at their locations. A breach of network security and systems or other events that cause the loss or public disclosure of, or access by third parties to, our customers stored information could have serious negative consequences for our business, including possible fines, penalties and damages, reduced demand for our solutions, an unwillingness of our customers to use our solutions, harm to our reputation and brand, and time-consuming and expensive litigation, any of which could have an adverse effect on our financial results.

Certain governmental agencies, such as the U.S. Department of Health and Human Services and the Federal Trade Commission, have the authority to protect against the misuse of consumer information by targeting companies that collect, disseminate or maintain personal information in an unfair or deceptive manner. We are also subject to the laws of those foreign jurisdictions in which we sell the CyberKnife and TomoTherapy Systems, some of which currently have more protective privacy laws. If we fail to comply with applicable regulations in this area, our business and prospects could be harmed.

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***We may be subject to claims that our employees have wrongfully used or disclosed alleged trade secrets of their former employers.***

As is common in the medical device industry, we employ individuals who were previously employed at other medical equipment or biotechnology companies, including our competitors or potential competitors. We may be subject to claims that we or these employees have inadvertently or otherwise used or disclosed trade secrets or other proprietary information of their former employers. Litigation may be necessary to defend or against these claims. For example, on September 3, 2009, Best Medical filed a lawsuit against us in the U.S. District Court for the Western District of Pennsylvania, claiming we induced certain individuals to leave the employment of Best Medical and join our company in order to gain access to Best Medical s confidential information and trade secrets. Best Medical is seeking monetary damages and other relief. We filed a motion for summary judgment on May 20, 2011, Best Medical filed its response on June 21, 2011, and we filed a response to their response on July 8, 2011. On October 25, 2011, the court granted summary judgment in our favor on all counts. On November 21, 2011 Best Medical filed a notice of appeal, and the parties await a ruling by the appellate court. Best Medical is seeking monetary damages and other relief. Even if we are successful in defending against claims of this nature, litigation could result in substantial costs and be a distraction to management.

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

*(a)* *Sales of Unregistered Securities*

None.

*(b)* *Use of Proceeds from Public Offering of Common Stock*

None.

*(c)* *Purchases of Equity Securities by the Issuer and Affiliated Purchasers*

None.

**Item 3.** **Defaults Upon Senior Securities**

None.

**Item 4.** **Not applicable**

**Item 5.** **Other Information**

None.

**Item 6.** **Exhibits**

| Exhibit Number | Description |
|---|---|
| 10.1 | Performance Bonus Plan |
| 31.1 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended. |
| 31.2 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended. |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. 1350 |
| 99.1 | Form of Performance Stock Unit Grant Notice and Performance Stock Unit Agreement |
| 99.2** | Form of Restricted Stock Unit Grant Notice and Restricted Stock Unit Agreement |
| 99.3** | Form of Stock Option Grant Notice and Stock Option Agreement |
| 101.INS* | XBRL Instance Document |
| 101.SCH* | XBRL Taxonomy Extension Schema Document |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase Document |

* XBRL (eXtensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

** Incorporated by reference to the Current Report on Form 8-K filed with the Securities and Exchange Commission on November 23, 2011

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ACCURAY INCORPORATED

| | |
|---|---|
| By: | /s/ Euan S. Thomson<br>Euan S. Thomson, Ph.D.<br>President and Chief Executive Officer |
| By: | /s/ Derek Bertocci<br>Derek Bertocci<br>Senior Vice President and Chief Financial Officer |

Date: February 8, 2012