ACCURAY INC
Form 10-Q
May 06, 2009
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 28, 2009

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 preceeding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o 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
(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 May 1, 2009, there were 56,071,372 shares of the Registrant s Common Stock, par value $0.001 per share, outstanding.

Table of Contents

Accuray Incorporated

Form 10-Q for the Quarter Ended March 31, 2009

Table of Contents

		Page No.
PART I.	**Financial Information**	3
Item 1.	Financial Statements (unaudited):	3
	Condensed Consolidated Balance Sheets	3
	Condensed Consolidated Statements of Operations	4
	Condensed Consolidated Statements of Cash Flows	5
	Notes to Condensed Consolidated Financial Statements	6
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	22
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	35
Item 4.	Controls and Procedures	36
PART II.	**Other Information**	37
Item 1.	Legal Proceedings	37
Item 1A.	Risk Factors	37
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	37
Item 3.	Defaults Upon Senior Securities	38
Item 4.	Submission of Matters to a Vote of Security Holders	38
Item 5.	Other Information	38
Item 6.	Exhibits	38
Signatures		39
Exhibit Index		40

Table of Contents

PART I. **FINANCIAL INFORMATION**

Item 1. **Financial Statements**

Accuray Incorporated

Condensed Consolidated Balance Sheets

(in thousands, except share amounts)

(unaudited)

	March 31, 2009	June 30, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 33,907	$ 36,936
Restricted cash	1,093	4,830
Short-term available-for-sale securities	64,333	85,536
Accounts receivable, net of allowance for doubtful accounts of $477 at March 31, 2009 and $27 at June 30, 2008	33,097	33,918
Inventories	28,562	23,047
Prepaid expenses and other current assets	4,978	6,431
Deferred cost of revenue current	21,621	31,667
Total current assets	187,591	222,365
Long-term available-for-sale securities	36,227	37,014
Long-term trading securities	21,660	
Deferred cost of revenue noncurrent	5,300	11,724
Property and equipment, net	14,830	17,140
Goodwill	4,495	4,495
Intangible assets, net	732	926
Other assets	1,340	1,340
Total assets	$ 272,175	$ 295,004
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 11,372	$ 12,962
Accrued compensation	10,986	7,504
Other accrued liabilities	4,906	4,369
Customer advances current	13,207	22,331
Deferred revenue current	74,104	87,455
Total current liabilities	114,575	134,621
Long-term liabilities:		
Customer advances noncurrent		2,900
Deferred revenue noncurrent	10,358	26,720
Total liabilities	124,933	164,241
Commitments and contingencies (Note 7)		
Stockholders 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: 58,052,062 and 56,719,864 shares at March 31, 2009 and June 30, 2008, respectively; outstanding: 55,912,044 and 54,579,846 shares at March 31, 2009 and June 30, 2008, respectively		56		55
Additional paid-in capital		268,811		252,901
Accumulated other comprehensive income (loss)		114		(1,067)
Accumulated deficit		(121,739)		(121,126)
Total stockholders equity		147,242		130,763
Total liabilities and stockholders equity	$	272,175	$	295,004

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

Table of Contents

Accuray Incorporated

Condensed Consolidated Statements of Operations

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2009	**2008**	**2009**	**2008**
Net revenue:				
Products	$ 41,006	$ 40,706	$ 119,762	$ 116,821
Shared ownership program	1,285	2,715	3,197	8,071
Services	17,901	11,017	47,730	26,966
Other	1,109	4,320	4,106	7,584
Total net revenue	61,301	58,758	174,795	159,442
Cost of revenue:				
Cost of products	17,630	19,411	49,894	52,332
Cost of shared ownership program	185	755	654	2,227
Cost of services	12,057	8,165	32,214	19,014
Cost of other	1,067	4,144	3,833	5,813
Total cost of revenue	30,939	32,475	86,595	79,386
Gross profit	30,362	26,283	88,200	80,056
Operating expenses:				
Selling and marketing	11,420	10,792	35,623	32,115
Research and development	9,259	8,632	26,807	24,475
General and administrative	8,821	7,943	28,513	23,820
Total operating expenses	29,500	27,367	90,943	80,410
Income (loss) from operations	862	(1,084)	(2,743)	(354)
Other income, net	575	1,345	2,436	6,154
Income (loss) before provision for income taxes	1,437	261	(307)	5,800
Provision (benefit) for income taxes	221	(323)	306	608
Net income (loss)	$ 1,216	$ 584	$ (613)	$ 5,192
Net income (loss) per share:				
Basic net income (loss) per share	$ 0.02	$ 0.01	$ (0.01)	$ 0.10
Shares used in computing basic net earnings per share	55,724	54,856	55,138	54,539
Diluted net income (loss) per share	$ 0.02	$ 0.01	$ (0.01)	$ 0.09
Shares used in computing diluted net earnings per share	58,772	60,125	55,138	60,862
Cost of revenue, selling and marketing, research and development, and general and administrative expenses include stock-based compensation charges as follows:				
Cost of revenue	$ 622	$ 514	$ 1,801	$ 1,364
Selling and marketing	$ 538	$ 1,081	$ 2,518	$ 3,227
Research and development	$ 797	$ 800	$ 2,330	$ 2,278
General and administrative	$ 1,167	$ 1,837	$ 5,027	$ 5,949

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

Table of Contents

Accuray Incorporated

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Nine Months Ended March 31,	
	2009	2008
Cash Flows From Operating Activities		
Net income (loss)	$ (613)	$ 5,192
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	4,983	6,029
Stock-based compensation	11,676	12,818
Tax benefit from stock-based compensation		388
Excess tax benefit from stock-based compensation	(356)	(298)
Realized gain on investments	(18)	
Unrealized loss on long-term trading securities, net of gain on put option	740	
Provision for bad debts	450	
Loss on write-down of inventories	2,638	448
Loss on disposal of property and equipment	203	194
Changes in assets and liabilities:		
Accounts receivable	592	(21,385)
Inventories	(9,234)	(4,467)
Prepaid expenses and other current assets	1,653	962
Deferred cost of revenue	17,088	21,426
Other assets	24	101
Accounts payable	(1,757)	(2,500)
Accrued liabilities	4,260	(2,494)
Customer advances	(12,253)	1,352
Deferred revenue	(30,003)	(35,785)
Net cash used in operating activities	(9,927)	(18,019)
Cash Flows From Investing Activities		
Purchases of property and equipment	(2,258)	(4,326)
Restricted cash	3,737	
Purchases of marketable securities	(116,061)	(108,918)
Sales and maturities of marketable securities	116,881	5,535
Net cash provided by (used in) investing activities	2,299	(107,709)
Cash Flows From Financing Activities		
Proceeds from issuance of common stock	3,168	3,622
Proceeds from employee stock purchase plan	806	1,888
Stock repurchases		(21,636)
Excess tax benefit from stock-based compensation	356	298
Net cash provided by (used in) financing activities	4,330	(15,828)
Effect of exchange rate changes on cash	269	(227)
Net decrease in cash and cash equivalents	(3,029)	(141,783)
Cash and cash equivalents at beginning of period	36,936	204,830
Cash and cash equivalents at end of period	$ 33,907	$ 63,047

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

Table of Contents

Accuray Incorporated

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. DESCRIPTION OF BUSINESS

Organization

Accuray Incorporated (the Company) was incorporated in California in December 1990 and commenced operations in January 1992. The Company was reincorporated in Delaware in February 2007 prior to the completion of its initial public offering (IPO). The Company designs, develops and sells the CyberKnife system, an image-guided robotic radiosurgery system used for the treatment of solid tumors anywhere in the body.

The Company has formed ten wholly-owned subsidiaries: Accuray International SARL, located in Geneva, Switzerland, Accuray Europe SAS, located in Paris, France, Accuray UK Ltd, located in London, United Kingdom, Accuray Asia Limited, located in Hong Kong, SAR, Accuray Japan KK, located in Tokyo, Japan, Accuray Spain, S.L.U., located in Madrid, Spain, Accuray Medical Equipment (India) Private Ltd., located in New Delhi, India, Accuray Medical Equipment (SEA) Private Limited, located in Singapore, Accuray Medical Equipment (Rus) LLC, located in Moscow, Russia and Accuray Medical Equipment GmbH, located in Munich, Germany. The purpose of these subsidiaries is to market the Company s products in the various countries in which they are located.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Fiscal Year

The Company s fiscal year ends on the Saturday closest to June 30th, so that in a 52 week period, each fiscal quarter consists of 13 weeks. The additional week in a 53-week year is added to the fourth quarter, making such quarter consist of 14 weeks. Fiscal years 2009 and 2008 are both comprised of 52 weeks. For ease of presentation purposes, the condensed financial statements and notes refer to March 31 as the Company s fiscal quarter end and June 30 as the Company s fiscal year end.

Basis of Presentation and Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All significant inter-company transactions and balances have been eliminated in consolidation. Certain prior period balances have been reclassified to conform to current period presentation.

The accompanying condensed consolidated balance sheet as of March 31, 2009, the condensed consolidated statements of operations for the three and nine months ended March 31, 2009 and 2008, and the condensed consolidated statements of cash flows for the nine months ended March 31, 2009 and 2008 and other information disclosed in the related notes are unaudited. The condensed consolidated balance sheet as of June 30, 2008 was derived from the Company s audited consolidated financial statements at that date. The accompanying condensed financial statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company s Annual Report on Form 10-K for the year ended June 30, 2008.

The accompanying condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles, (U.S. GAAP), pursuant to the rules and regulations of the Securities and Exchange Commission (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 to fairly state the Company s consolidated financial position as of March 31, 2009, consolidated results of operations for the three and nine months ended March 31, 2009 and 2008 and cash flows for the nine months ended March 31, 2009 and 2008. The results for the three and nine months ended March 31, 2009 are not necessarily indicative of the results to be expected for the year ending June 30, 2009 or for any other interim period or for any future year.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Significant estimates and assumptions made by the Company relate to stock-based compensation, valuation allowances for deferred tax assets, estimate of allowance for doubtful accounts, valuation of excess and obsolete inventories general inventory reserve requirements and impairment of long-lived assets and goodwill. Actual results could differ 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 average exchange rates during the year. Resulting translation adjustments are recorded directly to accumulated comprehensive income within the statement of stockholders equity. Foreign currency transaction gains and losses are included as a component of other income (expense).

Table of Contents

Cash and Cash Equivalents

The Company considers all investments with original maturities of three months or less to be cash equivalents. Cash equivalents amounted to $24.8 million and $30.7 million at March 31, 2009 and June 30, 2008, respectively. Cash and cash equivalent balances denominated in a foreign currency amounted to $2.1 million and $1.0 million at March 31, 2009 and June 30, 2008, respectively.

Marketable Securities

The Company s short-term available-for-sale securities on the condensed consolidated balance sheets include fixed-income securities, commercial paper, term notes and marketable debt securities. All marketable securities designated as available-for-sale are reported at fair value, with unrealized gains and losses recorded in accumulated other comprehensive income (loss). Realized gains and losses on the sale of available-for-sale marketable securities are recorded in other income (expense). The cost of available-for-sale marketable securities sold is based on the specific identification method. Available-for-sale marketable securities with original maturities greater than approximately three months and remaining maturities less than one year are classified as short-term available-for-sale marketable securities. Long-term available-for-sale marketable securities include U.S. corporate debt securities with maturities beyond one year.

The Company s long-term trading securities on the condensed consolidated balance sheets consist of (i) auction-rate securities (ARS) that are AAA-rated and are secured by pools of student loans guaranteed by state regulated higher education agencies and reinsured by the U.S. Department of Education and (ii) a put option held in respect to these ARS (see Note 3). Changes in the fair value of the Company s trading securities are reported in other income (expense).

Interest and dividends on all of the Company s marketable securities are included in Other income, net .

Fair Value of Financial Instruments

The carrying values of the Company s financial instruments including cash and cash equivalents, restricted cash, short-term marketable securities, accounts receivable and accounts payable are approximately equal to their respective fair values due to the relatively short-term nature of these instruments.

Concentration of Credit Risk and Other Risks and Uncertainties

The Company s cash, cash equivalents and marketable securities are stated at their estimated fair values, based on quoted market prices for the same or similar instruments. These financial instruments are placed with a number of financial institutions, which limits the credit exposure from any one financial institution or instrument.

Accounts receivable are 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. The Company s allowance for doubtful accounts was approximately $477,000 and $27,000 as of March 31, 2009 and June 30, 2008, respectively. For the three months ended March 31, 2009, the Company had one customer that represented approximately 17% of revenue. There were no customers that represented more than 10% of revenue for the nine months ended March 31, 2009. For the three and nine months ended March 31, 2008, the Company had one customer that represented approximately 16% and 11% of revenue, respectively. At March 31, 2009 and June 30, 2008, the Company had two and three customers that represented approximately 25% and 44% of accounts receivable, respectively.

The Company is subject to risks common to companies in the medical device industry including, but not limited to: new technological innovations, dependence on key personnel, dependence on key suppliers, protection of proprietary technology, compliance with government regulations, uncertainty of widespread market acceptance of products, product liability and the need to obtain additional financing. The Company s products include components subject to rapid technological change. Certain components used in manufacturing have relatively few alternative sources of supply, and establishing additional or replacement suppliers for such components cannot be accomplished quickly. While the Company has ongoing programs to minimize the adverse effect of such uncertainty and considers technological change in estimating its allowances, uncertainty continues to exist.

The products currently under development by the Company may require clearance by the U.S. Food and Drug Administration (FDA) or other international regulatory agencies prior to commercial sales. There can be no assurance that the Company s products will receive the necessary clearance. If the Company is denied such clearance or such clearance is delayed, such delays or denials could have a material adverse impact on the Company.

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 consulting. The Company s products and upgrades to those products include software that is essential to the functionality of the products and, accordingly, the Company accounts for the sale of its products pursuant to Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, (SOP 97-2) as amended.

The Company recognizes product revenues for sales of the CyberKnife system, upgrades, components and replacement parts and accessories when there is persuasive evidence of an arrangement, the fee is fixed or determinable, collection of the fee is probable and delivery has occurred as prescribed by SOP 97-2. 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.

Table of Contents

For arrangements with multiple elements, 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 management having the relevant authority 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 CyberKnife system, based upon the residual method as prescribed by SOP No. 98-9, *Modification of SOP No. 97-2 with Respect to Certain Transactions* (SOP 98-9). 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 or (2) establishment of VSOE of fair value for all remaining undelivered elements.

CyberKnife sales with legacy service plans

For sales of CyberKnife systems with PCS arrangements that include specified or committed upgrades for which the Company has not established VSOE of fair value, all revenue is deferred and accounted for as described above. Once all such upgrade obligations have been delivered, all accumulated deferred revenue is recognized ratably over the remaining life of the PCS arrangement.

Sales of additional upgrades as optional extras prior to the delivery of all specified upgrade obligations are considered additional elements of the original arrangement and associated revenues are deferred and accounted for as described above. Sales of additional upgrades after delivery of all specified upgrade obligations, as stated in the original contract, are recognized once all revenue recognition criteria applicable to those arrangements are met.

CyberKnife sales with nonlegacy service plans

In fiscal 2006, the Company began selling CyberKnife systems with PCS contracts that only provide for upgrades when and if they become available. The Company has established VSOE of the fair value of PCS in these circumstances. For arrangements with multiple elements that include the CyberKnife system, installation services, training services and a PCS service agreement, the Company recognizes the CyberKnife system and installation services revenue following installation and acceptance of the system by application of the residual method as prescribed in SOP 98-9 when VSOE of fair value exists for all undelivered elements in the arrangement, including PCS.

Other revenue Japan upgrade services

Other revenue primarily consists of upgrade services revenues related to the sale of specialized services specifically contracted to provide current technology capabilities for systems previously sold through a distributor into the Japan market. Some upgrade sales include elements where VSOE of fair value has not been established for the PCS. As a result, for these sales, associated revenues are deferred and recognized ratably over the term of the PCS arrangement, generally four years.

PCS and maintenance services

Service revenue for providing PCS, which includes warranty services, extended warranty services, unspecified when and if available product updates and technical support is deferred and recognized ratably over the service period, generally one year, until no further obligation exists. At the time of sale, the Company provides for the estimated incremental costs of meeting product warranty if the incremental warranty costs are expected to exceed the related service revenues. Training and consulting service revenues that are not deemed essential to the functionality of the CyberKnife system are recognized as such services are performed.

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

Distributor sales

Sales to third party distributors are evidenced by distribution agreements governing the relationship together with binding purchase orders on a transaction-by-transaction basis. The Company records revenues from sales of CyberKnife systems to distributors based on a sell-through method where revenue is only recognized upon shipment of the product to the end user customer or proof of sell-through to end user customer is provided and once all other revenue recognition criteria are met including completion of all obligations under the terms of the purchase order. For sales of 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 and once all revenue recognition criteria are met. These criteria require that persuasive evidence of an arrangement exist, the fees are fixed or determinable, collection of the resulting receivable is probable and there is no right of return.

The Company s agreements with customers and distributors generally do not contain product return rights.

Table of Contents

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 of a fee is not probable, the Company will defer the fee and recognize revenue upon receipt of cash.

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 CyberKnife 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 from the customer are deferred and recognized as revenue over the contractual period. Revenues from the shared ownership program are recorded as they become earned and receivable and are included within shared ownership program revenues in the condensed consolidated statements of operations. The Company recognized $1.3 million and $3.2 million for the three and nine months ended March 31, 2009, respectively, of revenue from the shared ownership program. The Company recognized $2.7 million and $8.1 million for the three and nine months ended March 31, 2008, respectively, of revenue from the shared ownership program.

Future minimum revenues under shared ownership arrangements as of March 31, 2009 are as follows (in thousands):

2009 (remaining three months)	$	60
2010		240
2011		240
2012		240
2013 and thereafter		180
Total	$	960

Total usage-based fee revenues, which are included in shared ownership program revenue, earned from the CyberKnife systems under the shared ownership program amounted to $1.2 million and $2.8 million for the three and nine months ended March 31, 2009, respectively, and $2.0 million and $6.0 million for the three and nine months ended March 31, 2008, respectively.

Under the terms of the shared ownership program, the customer has the option to purchase the CyberKnife system at pre-determined prices based on the period the system has been in use and considering the 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. Product revenue of $1.2 million was recognized from the sale of one CyberKnife system that was formerly a part of the Company s shared ownership program during the three and nine months ended March 31, 2009. During the three and nine months ended March 31, 2008, $14.1 million and $20.6 million, respectively, of total revenue was recognized in the condensed consolidated statements of operations for the sale of 7 and 10 CyberKnife systems, respectively, that were formerly part of the Company s shared ownership program.

The CyberKnife systems associated with the Company s shared ownership program are recorded within property and equipment and are depreciated over their estimated useful life of ten years. Depreciation and warranty expense attributable to the CyberKnife shared ownership systems are recorded within cost of shared ownership program.

Long-term manufacturing contracts

The Company recognizes revenue and cost of revenue related to long-term manufacturing contracts using contract accounting on the percentage-of-completion method in accordance with SOP No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts.* Contract revenue of $890,000 and $1.9 million was recorded during the three and nine months ended March 31, 2009. Related costs of $907,000 and $2.0 million were recorded during the same periods. Contract revenue of $500,000 and related contract costs of $438,000 were recorded during the three and nine months ended March 31, 2008. The Company recognizes any loss provisions from the total contract in the period such loss is identified. During the nine months ended March 31, 2009, increases in projected costs to complete were sufficient to create a loss position for certain projects. As such, an estimated loss provision of $17,000 and $104,000 was recognized during the three and nine months ended March 31, 2009, respectively. No loss provision was recognized during the three and nine months ended March 31, 2008. As of March 31, 2009 and June 30, 2008, costs of $98,000 and $1.0 million, respectively, were recorded in deferred cost of revenue related to long-term manufacturing contracts.

Table of Contents

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 the 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 monthly minimum lease payments, which 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. Deferred other revenue results primarily from the Japan upgrade services programs and is due to timing differences between the receipt of cash payments for those upgrades and final delivery to the end user customer. Deferred cost of revenue consists of the direct costs associated with the manufacture of systems, direct service costs and deferred costs associated with the Japan upgrade services programs 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.

Customer Advances

Customer advances represent payments made by customers in advance of product shipment. Customer advances related to product shipments expected to occur within one year are classified as current liabilities.

Research and Development Costs

Costs related to research, design and development of products, and clinical studies are charged to research and development expense as incurred. These costs include direct salary costs for research and development personnel, costs for materials used in research and development activities, costs for outside services and allocated portions of facilities and other corporate costs. The Company has entered into research and clinical study arrangements with selected hospitals, cancer treatment centers, academic institutions and research institutions worldwide. These agreements support the Company s internal research and development capabilities and are charged to research and development as incurred.

Stock-Based Compensation

The Company recognizes stock-based compensation expense in accordance with SFAS No. 123(R), *Share-Based Payment, an amendment of FASB Statements Nos. 123 and 95* (SFAS 123R). Under SFAS 123R, the Company estimated the fair value of each option award on the date of grant using the Black-Scholes option-pricing model using the assumptions noted in the table below. Expected volatility was based on the historical volatility of a peer group of publicly traded companies. The expected term of options was based upon the vesting term (for example, 25% on the first anniversary of the vesting start date and 36 equal monthly installments thereafter) and on its partial life history. The risk-free rate for the expected term of the option is based on the U.S. Treasury Constant Maturity rate.

The estimated fair value of the stock options granted was calculated at each date of grant using the Black-Scholes option pricing model, using fair values of common stock between $3.75 and $8.99 per share during the three and nine months ended March 31, 2009, and between $7.84 and $22.86 per share during the three and nine months ended March 31, 2008. The fair value of the Company s common stock is determined by its closing market price as published by the Nasdaq Global Market. During the three and nine months ended March 31, 2009, the Company recognized $2.2 million and $7.2 million, respectively, of stock-based compensation expense, net of estimated forfeitures, for stock options granted to employees. During the three and nine months ended March 31, 2008, the Company recognized $3.0 million and $9.2 million, respectively, of stock-based compensation expense, net of estimated forfeitures, for stock options granted to employees. Weighted-average grant date fair values for the three and nine months ended March 31, 2009 were $3.11 and $4.02, respectively. Weighted-average grant date fair values for the three and nine months ended March 31, 2008 were $7.32 and $8.38, respectively. The following weighted-average assumptions were used to value options granted during the three and nine months ended March 31, 2009 and 2008, respectively:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2009	**2008**	**2009**	**2008**
Risk-free interest rate	2.10%	2.92%	2.58%	3.68%
Dividend yield				
Expected life	6.25	6.25	6.25	6.25
Expected volatility	65.4%	60.1%	64.3%	60.3%

During the three and nine months ended March 31, 2009, the Company recognized $32,000 and $929,000 of stock-based compensation expense related to accelerated vesting of stock options and restricted stock units (RSUs) in conjunction with employee separation costs.

In January 2007, in connection with the Company s initial public offering, or IPO, the Board of Directors approved the 2007 Incentive Award Plan (2007 Plan) and 2007 Employee Stock Purchase Plan (ESPP). The ESPP is deemed compensatory and compensation costs are accounted for under SFAS 123R.

Table of Contents

Under the ESPP, qualified employees are entitled to purchase common stock at 85% of the fair market value on specified dates. The estimated fair value of ESPP shares are calculated at the date of grant using the Black-Scholes option pricing model, using the fair value of common stock determined by the Company s closing market price on the date of grant, as published by the Nasdaq Global Market. Expected volatility is based on the historical volatility of a peer group of publicly traded companies. The expected term is based upon the offering period of the ESPP. The risk-free rate for the expected term of the ESPP option is based on the U.S. Treasury Constant Maturity rate. For the three and nine months ended March 31, 2009, the Company recognized $241,000 and $761,000, respectively, of compensation expense related to its ESPP. For the three and nine months ended March 31, 2008, the Company recognized $320,000 and $883,000, respectively, of compensation expense related to its ESPP. The following weighted-average assumptions were used to value ESPP shares at the date of grant:

	Three and Nine Months Ended March 31,	
	2009	**2008**
Risk-free interest rate	0.44%	3.28%
Dividend yield		
Expected life	0.50	0.50
Expected volatility	85.4%	58.5%

In connection with the 2007 Plan, the Company issued RSUs and recognized $638,000 and $2.8 million of stock-based compensation expense, net of estimated forfeitures, for RSUs granted during the three and nine months ended March 31, 2009, respectively. The Company recognized $942,000 and $2.8 million of stock-based compensation expense, net of estimated forfeitures, for RSUs granted during the three and nine months ended March 31, 2008, respectively. Weighted-average grant date fair values for the three and nine months ended March 31, 2009 were $5.53 and $6.55, respectively. Weighted-average grant date fair values for the three and nine months ended March 31, 2008 were $14.42 and $15.16, respectively.

Excess tax benefits from tax deductions for exercised options and disqualifying dispositions in excess of the deferred tax asset attributable to stock compensation costs for such options are credited to additional paid-in capital. Realized excess tax benefits for the three and nine months ended March 31, 2009 was $356,000. Realized excess tax benefits (shortfall) for the three and nine months ended March 31, 2008 were ($330,000) and $388,000, respectively.

At March 31, 2009 and June 30, 2008, capitalized stock-based compensation costs of $468,000 and $489,000, respectively, were included as components of inventory and deferred cost of revenue.

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 dilutive common shares outstanding during the period. Dilutive shares outstanding are calculated by adding to the weighted shares outstanding any common stock equivalents from outstanding stock options, RSUs and warrants based on the treasury stock method. In periods when net income is reported, the calculation of diluted net income per share typically results in lower earnings per share than is calculated using the basic method. In periods when a net loss is reported, potential shares from stock options, restricted stock units and warrants are not included in the calculation because they would have an anti-dilutive effect, meaning the loss per share would be reduced. Therefore, in periods when a loss is reported, the calculation of basic and diluted net loss per share results in the same value.

For the three and nine months ended March 31, 2009, basic net income (loss) per share was based on weighted-average shares of 55,724,222 and 55,137,943, respectively. For the three and nine months ended March 31, 2008, basic net income per share was based on weighted-average shares of 54,856,226 and 54,538,778, respectively. For the three and nine months ended March 31, 2009, diluted net income (loss) per share was based on weighted-average shares of 58,772,040 and 55,137,943, respectively. For the three and nine months ended March 31, 2008, diluted net income per share was based on weighted-average shares of 60,125,124 and 60,862,410, respectively. The number of anti-dilutive shares excluded from the calculation of diluted income (loss) per share was as follows:

	Three Months Ended March 31,		**Nine Months Ended March 31,**	
	2009	**2008**	**2009**	**2008**
Options to purchase common stock	3,696,329	2,564,568	9,013,255	1,007,517
Restricted stock units	639,167	717,586	588,459	632,299
	4,335,496	3,282,154	9,601,714	1,639,816

Table of Contents

The following table sets forth the basic and diluted per share computations:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2009	2008	2009	2008
Numerator:				
Net income (loss) (in thousands)	$ 1,216	$ 584	$ (613)	$ 5,192
Denominator:				
Basic weighted-average shares outstanding	55,724,222	54,856,226	55,137,943	54,538,778
Stock option and restricted stock unit common share equivalents	3,047,818	5,268,898		6,323,632
Diluted weighted-average shares of common stock and equivalents outstanding	58,772,040	60,125,124	55,137,943	60,862,410
Basic net income (loss) per share:	$ 0.02	$ 0.01	$ (0.01)	$ 0.10
Diluted net income (loss) per share:	$ 0.02	$ 0.01	$ (0.01)	$ 0.09

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 carry forwards 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.

The Company had $1.4 million of unrecognized tax benefits as of June 30, 2008, all of which would affect its income tax expense if recognized. The unrecognized tax benefits mainly relate to federal and state net operating losses and research tax credits. In the three and nine months ended March 31, 2009, none of the related benefits have been realized. The Company files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. Due to attributes being carried forward, the statute of limitations remains open for the U.S. federal jurisdiction and domestic states for tax years from 1999 forward. The statute of limitations in France remains open from 2005 and Hong Kong remains open from 2002. The Company s subsidiary, Accuray Europe SAS, incurred non-income tax related penalties and interest of $122,000 as the result of the French tax audit for the tax years 2005 to 2007, recorded in other income, net for the three and nine months ended March 31, 2009.

During the three months ended March 31, 2009, the Company recorded tax provisions of $356,000, related to book-to-tax differences for fixed assets and a benefit of $146,000 for U.S. federal refundable credits as provided by the Housing and Economic Recovery Act of 2008 (Act). The Act, effective July 2008, allows taxpayers to claim refundable alternative minimum tax or research and development credit carryovers if they forego bonus depreciation on certain qualified fixed assets placed in service between April and December 2008 and from January 1, 2009 through December 31, 2009. The Company estimated and recognized credits based on fixed assets placed into service through the nine months

ended March 31, 2009.

In accordance with SFAS No.109, *Accounting for Income Taxes,* the Company classifies interest and penalties resulting from an underpayment of income taxes, if any, as a component of tax expense. Such interest and penalties were immaterial as of March 31, 2009.

The Company adopted the provisions of Emerging Issues Task Force (EITF) Issue No. 06-03, *How Taxes Collected from Customers and Remitted to Government Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)* (EITF 06-03), effective January 1, 2007. EITF 06-03 allows companies to choose either the gross basis or net basis of income statement presentation for taxes collected from customers and remitted to governmental authorities and requires companies to disclose such policy. The Company applies the net basis presentation for taxes collected from customers and remitted to government authorities.

Segment Information

The Company has determined that it operates in only one segment in accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131) 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.

Table of Contents

Revenue by geographic region is based on the shipping addresses of the Company s customers. The following summarizes revenue by geographic region (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2009	2008	2009	2008
United States (including Puerto Rico)	$ 49,074	$ 48,102	$ 126,890	$ 109,652
Europe	10,045	533	22,571	5,088
Asia (excluding Japan)	1,147	4,153	15,901	31,119
Japan	1,035	5,970	9,433	13,583
Total	$ 61,301	$ 58,758	$ 174,795	$ 159,442

Recent Accounting Pronouncements

In April 2009, the FASB issued FASB Staff Position (FSP) FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS 157-4). FSP FAS 157-4 provides guidance on (1) estimating the fair value of an asset or liability when the volume and level of activity for the asset or liability have significantly decreased and (2) identifying transactions that are not orderly. This FSP is effective for the first reporting period (interim or annual) ending after June 15, 2009, with earlier application permitted. The adoption of FSP FAS 157-4 is not expected to have a material impact on the Company s condensed consolidated financial statements.

Also in April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS 115-2). FSP FAS 115-2 requires entities to initially apply the provisions of the standard to previously other than temporarily impaired debt securities (debt securities that the Company does not intend to sell and that the Company is not more likely than not required to sell before recovery), existing as of the date of initial adoption, by making a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. This FSP is effective for the first reporting period (interim or annual) ending after June 15, 2009, with earlier application permitted. The adoption of FSP FAS 115-2 is not expected to have a material impact on the Company s condensed consolidated financial statements.

Also in April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures About Fair Value of Financial Instruments* (FSP FAS 107-1). FSP FAS 107-1 expands the fair value disclosures required for all financial instruments within the scope of FASB Statement No. 107, *Disclosures About Fair Value of Financial Instruments* (FAS 107), to interim periods. It also requires entities to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments in financial statements on an interim and annual basis and to highlight any changes from prior periods. This FSP is effective for the first reporting period (interim or annual) ending after June 15, 2009, with earlier application permitted. The adoption of FSP FAS 107-1 is not expected to have a material impact on the Company s condensed consolidated financial statements.

The FASB also issued FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise From Contingencies* (FSP FAS 141(R)-1) in April 2009. Under the FSP, an acquirer is required to recognize at fair value an asset acquired or a liability assumed in a business combination that arises from a contingency if the acquisition-date fair value of that asset or liability can be determined during the measurement period. If the acquisition-date fair value cannot be determined, then the acquirer follows the recognition criteria in FASB Statement No. 5, *Accounting for Contingencies,* and FASB Interpretation No. 14*, Reasonable Estimation of the Amount of a Loss an interpretation of FASB Statement No. 5,* to determine whether the contingency should be recognized as of the acquisition date or after it. This FSP is effective for business combinations whose acquisition date is on or after the beginning of the first annual reporting period

beginning on or after December 15, 2008. The adoption of FSP FAS 141(R)-1 is not expected to have a material impact on the Company s condensed consolidated financial statements.

3. FINANCIAL INSTRUMENTS

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value, with changes in fair value recognized in earnings each reporting period. The election, called the fair value option, will enable entities to achieve an offset accounting effect for changes in fair value of certain related assets and liabilities without having to apply complex hedge accounting provisions. In November 2008, the Company entered into an agreement (Rights Agreement) with UBS, which provides the Company with ARS Rights (Rights) to sell its ARS at par value to UBS at any time during the period June 30, 2010 through July 2, 2012. These Rights are a separate freestanding instrument accounted for separately from the ARS, and are registered, nontransferable securities accounted for as a put option initially recorded at fair value. Under the Rights Agreement, UBS may, at its discretion, purchase or sell the ARS at any time through July 2, 2012 without prior notice to the Company and must pay the Company par value for the ARS within one day of the sale transaction settlement. The Company agreed to release UBS from certain potential claims related to its marketing and sale of ARS. Additionally, UBS offered a no net cost loan to the Company up to 75% of par value of the ARS as determined by UBS until June 30, 2010 (See Note 10).

Table of Contents

The Company elected fair value accounting for the put option recorded in connection with the Rights Agreement. This election was made in order to mitigate volatility in earnings caused by accounting for the purchased put option and underlying ARS under different methods. The initial election of fair value resulted in a gain included in Other income, net for the put option which is recorded in long-term trading securities.

Due to the Company entering into this Rights Agreement with UBS and enabling UBS to sell the ARS at any time, the ARS previously reported as available-for-sale have been transferred to trading securities and are classified as long-term trading securities on the condensed consolidated balance sheet as of March 31, 2009. Due to the change in classification to trading securities, at the time of entering into the Rights Agreement, the Company transferred the previously accumulated unrealized loss of $3.8 million from Accumulated other comprehensive income (loss) to Other income, net and recorded an additional unrealized loss of $407,000 relating to the change in fair value of the trading securities from November 2008 through December 31, 2008 in Other income, net . During the three months ended March 31, 2009, the Company recorded an unrealized gain of $250,000 related to the change in fair value of the ARS. At March 31, 2009, the total fair value of the ARS was $18.5 million, net of $3.9 million of unrealized losses.

Additionally, the Company recorded unrealized gains of $3.3 million related to the fair value of the put option through December 31, 2008. During the three months ended March 31, 2009, the Company recorded unrealized losses of $130,000, for a total fair value of the put option of $3.2 million as of March 31, 2009. During the three months ended March 31, 2009, the $250,000 unrealized gain in fair value of the ARS and the $130,000 of unrealized loss on the put option resulted in a net $120,000 increase to Other income, net .

The Company adopted SFAS No. 157, *Fair Value Measurements* (SFAS 157), subject to the deferral provisions of FSP FAS 157-2, *Effective Date of FASB Statement No. 157,* on July 1, 2008. This standard defines fair value, establishes a framework for measuring fair value and expands disclosure requirements about fair value measurements. SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy prescribed by SFAS 157 contains three levels as follows:

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

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

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

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

Assets and Liabilities that are Measured at Fair Value on a Recurring Basis

The fair value hierarchy requires the use of observable market data when available. In instances in which the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company s assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset or liability. The following table sets forth by level within the fair value hierarchy the Company s financial assets that were accounted for at fair value on a recurring basis at March 31, 2009, according to the valuation techniques the Company used to determine their fair values:

	Fair Value at March 31, 2009	Fair Value Measurements Using Inputs Considered as Level 1	Level 2	Level 3
	(in thousands)			
Money market funds	$ 24,755	$ 24,755	$	$
Corporate notes	27,001		27,001	
Commercial paper	19,351		19,351	
U.S. government and governmental agency obligations	54,208		54,208	
Auction-rate securities	18,474			18,474
Put option	3,186			3,186
Total	$ 146,975	$ 24,755	$ 100,560	$ 21,660

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended March 31, 2009. The Company classifies financial instruments in Level 3 of the fair value hierarchy when there is reliance on at least one significant unobservable input to the valuation model. In addition to these unobservable inputs, the valuation models for Level 3 financial instruments typically also rely on a number of inputs that are readily observable either directly or indirectly. Thus, the gains and losses presented below include changes in the fair value related to both observable and unobservable inputs.

Table of Contents

	Three Months Ended March 31, 2009	Nine Months Ended March 31, 2009
	(in thousands)	
Beginning balance	$ 21,540	$ 21,509
Change in temporary valuation adjustment previously recorded in Accumulated Other Comprehensive Income		891
Unrealized gain (loss) on auction rate securities included in earnings (1)	250	(3,926)
Acquisition of purchased put option		3,316
Unrealized loss on put option included in earnings (1)	(130)	(130)
Balance at March 31, 2009	$ 21,660	$ 21,660

(1) Represents the amount of total losses for the period included in earnings relating to assets still held on March 31, 2009.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Money market funds. Money market funds are classified as cash and cash equivalents on the Company s condensed consolidated balance sheet.

Corporate notes. Corporate notes are floating-rate obligations that are payable on demand. These are classified as available-for-sale within short-term marketable securities on the Company s condensed consolidated balance sheet. The market approach was used to value the Company s variable-rate demand notes. The Company classified these securities as Level 2 instruments due to either its usage of observable market prices in less active markets or, when observable market prices were not available, its use of non-binding market prices that are corroborated by observable market data or quoted market prices for similar instruments.

Commercial paper. Commercial paper is an unsecured, short-term debt instrument issued by corporations and financial institutions that generally mature within 270 days. The entire $19.4 million held in commercial paper is classified as short-term marketable securities on the Company s condensed consolidated balance sheet. The portion in cash and cash equivalents represents highly liquid debt instruments with insignificant interest rate risk and original maturities of ninety days or less. The market approach was used to value the Company s commercial paper. The Company classified these securities as Level 2 instruments due to either its usage of observable market prices in less active markets or, when observable market prices were not available, its use of non-binding market prices that are corroborated by observable market data or quoted market prices for similar instruments.

U.S. government and governmental agency obligations. U.S. government and governmental agency obligations are issued by state and local governments and other governmental entities such as authorities or special districts. These are classified as short-term marketable securities on the Company s condensed consolidated balance sheet. The market approach was used to value the Company s U.S. government and governmental agency obligations. The Company classified these securities as Level 2 instruments due to either its usage of observable market prices in less active markets or, when observable market prices were not available, its use of non-binding market prices that are corroborated by observable market data or quoted market prices for similar instruments.

Auction-rate securities. As of March 31, 2009, there was insufficient observable market information available to determine the fair value of the Company s ARS. Prior to December 31, 2008, the Company estimated Level 3 fair values for these securities based on the financial institutions broker s valuations. The financial institution broker valued student loan ARS as floating rate notes with three pricing inputs: the coupon, the current discount margin or spread, and the maturity. The coupon was generally assumed to equal the maximum rate allowed under the terms of the instrument, the current discount margin was based on an assessment of observable yields on instruments bearing comparable risks, and the maturity was based on an assessment of the terms of the underlying instrument and the potential for restructuring the ARS. The primary unobservable input to the valuation was the maturity assumption which was set at five years for the majority of ARS instruments. Through January 6, 2008, the ARS were valued at par value due to the frequent resets that historically occurred through the auction process.

As of March 31, 2009, the Company engaged a third party valuation service to model Level 3 fair value using an income approach. The Company reviewed the methodologies employed by the third party models. This included a review of all relevant data inputs and the appropriateness of key model assumptions.

The pricing assumptions for the ARS included the coupon rate, the estimated time to liquidity, current market rates for publicly traded corporate debt of similar credit rating and an adjustment for lack of liquidity. The coupon rate was assumed to equal the stated maximum auction rate being received, which is determined based on the applicable 91-day U.S. Treasury rate plus 1.20%

Table of Contents

premium according to provisions outlined in each security s agreement. The estimated time to liquidity was 3.25 years based on (i) expectations from industry brokers for liquidity in the market and (ii) the period over which UBS and other broker-dealers that had issued ARS have agreed to redeem certain ARS at par value.

The put option (see above) gives the Company the right to sell the ARS to UBS for a price equal to par value during the period June 30, 2010 to July 2, 2012, providing liquidity for the ARS sooner than the estimated 3.25 years. As the Company plans to exercise the put option on or around June 30, 2010, the value of the put option lies in (i) the ability to sell the securities thereby creating liquidity approximately two years before the ARS market is expected to become liquid and (ii) the avoidance of receiving below-market coupon rate while the security is illiquid and auctions are failing. The fair value of the put option represents the difference between the ARS with an estimated time to liquidity of 3.25 years and the ARS with an estimated time to liquidity of 1.5 years as the put option allows for the acceleration of liquidity and the avoidance of a below market coupon rate over the 1.5 year time period.

4. BALANCE SHEET COMPONENTS

Accounts receivable, net

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

	March 31, 2009	June 30, 2008
Accounts receivable	$ 32,842	$ 33,264
Unbilled fees and services	732	681
	33,574	33,945
Less: Allowance for doubtful accounts	(477)	(27)
Accounts receivable, net	$ 33,097	$ 33,918

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market, and consist of the following (in thousands):

	March 31, 2009	June 30, 2008
Raw materials	$ 11,451	$ 8,853
Work-in-process	10,171	3,967
Finished goods	6,940	10,227
Total inventories	$ 28,562	$ 23,047

Property and Equipment, net

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

	March 31, 2009	June 30, 2008
Furniture and fixtures	$ 3,527	$ 3,379
Computer and office equipment	7,658	6,912
Leasehold improvements	7,612	7,579
Machinery and equipment	13,885	12,287
CyberKnife shared ownership systems	2,521	3,951
	35,203	34,108
Less: Accumulated depreciation and amortization	(20,373)	(16,968)
Property and equipment, net	$ 14,830	$ 17,140

Depreciation and amortization expense related to property and equipment for the three and nine months ended March 31, 2009 was $1.6 million and $4.8 million, respectively. Depreciation and amortization expense related to property and equipment for the three and nine months ended March 31, 2008 was $2.1 million and $5.8 million, respectively. Accumulated depreciation related to the CyberKnife systems attributable to the shared ownership program at March 31, 2009 and June 30, 2008 was $928,000 and $1.6 million, respectively.

5. INVESTMENT

On July 29, 2008, the Company and Morphormics, Inc. (Morphormics) entered into a Stock Purchase Agreement pursuant to which the Company agreed to purchase 120,000 shares of Morphormics Series C Preferred Stock at $12.50 per share, for a total purchase price of $1.5 million. In exchange, Morphormics granted the Company a non-exclusive worldwide license to integrate several of its software products into the Company s treatment planning software. The equity investment afforded the Company a voting interest of approximately 18% in Morphormics. The Company s equity is considered to be at risk and is deemed not sufficient to finance Morphormics current product development activities without additional subordinated financial support. In addition, the

Table of Contents

Company is deemed to be Morphormics primary beneficiary; therefore, it would absorb a majority of expected losses. Pursuant to guidance in FASB Interpretation 46(R), *Consolidation of Variable Interest Entities* (FIN 46(R)), the Company is required to consolidate Morphormics in its financial results under GAAP. The consolidation of Morphormics assets and liabilities did not have a material effect on the Company s condensed consolidated balance sheet at March 31, 2009. Subsequent to July 29, 2008, the Company has recorded losses of $725,000 on its investment in Morphormics. The remaining $775,000 of the Company s investment remains at risk as of March 31, 2009.

6. GOODWILL AND OTHER PURCHASED INTANGIBLES

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142), goodwill and other intangible assets with indefinite lives are not amortized. Intangible assets with determinable useful lives are amortized on a straight line basis over their useful lives. SFAS 142 requires that the Company perform an annual test for impairment of intangible assets with indefinite lives, and interim tests if indications of potential impairment exist. The Company performed the annual test for impairment in December 2008 concluding that there was no impairment of goodwill.

The amortization expense relating to intangible assets for both the three and nine months ended March 31, 2009 and 2008 was approximately $65,000 and $194,000, respectively. The following represents the gross carrying amounts and accumulated amortization of amortized intangible assets at March 31, 2009 and June 30, 2008 (in thousands):

	March 31, 2009	June 30, 2008
Complete technology	$ 1,740	$ 1,740
Customer contract / relationship	70	70
	1,810	1,810
Less: Accumulated amortization	(1,078)	(884)
Intangible assets, net	$ 732	$ 926

The following table represents the estimated useful life of the intangible assets subject to amortization:

	Years
Amortized intangible assets:	
Complete technology	7.0
Customer contract / relationship	7.0

The estimated future amortization expense of purchased intangible assets as of March 31, 2009, is as follows (in thousands):

2009 (remaining three months)	$ 65
2010	258
2011	258
2012	151
Total	$ 732

7. COMMITMENTS AND CONTINGENCIES

Royalty Agreements

In July 1997, the Company entered into a license and royalty agreement with Stanford University (Stanford) under which the Company has a non-exclusive license to use certain technology. Under this agreement, the Company is obligated to pay Stanford up to $10,000 for each CyberKnife system sold that includes the licensed technology, with the stipulation that the Company must make minimum annual payments of $25,000. Royalty expense recorded in cost of revenue or deferred cost of revenue was $40,000 and $140,000 for the three and nine months ended March 31, 2009, respectively. Royalty expense recorded in cost of revenue or deferred cost of revenue was $35,000 and $115,000 for the three and nine months ended March 31, 2008, respectively. At March 31, 2009 and June 30, 2008, the Company had accrued approximately $40,000, included in other accrued liabilities in the condensed consolidated balance sheets relating to this license and royalty agreement.

In January 1999, the Company entered into a license and royalty agreement with Professor Dr. Achim Schweikard (Schweikard) of the University of Munich. Under this agreement, the Company has a non-exclusive license to use certain technology. The Company is obligated to pay Schweikard up to $5,000 for each CyberKnife system sold that includes the licensed technology, with the stipulation that the Company must make minimum annual payments of $5,000. Royalty expense under this agreement recorded in cost of revenue or deferred cost of revenue was $40,000 and $140,000 for the three and nine months ended March 31, 2009, respectively. Royalty expense under this agreement recorded in cost of revenue or deferred cost of revenue was $30,000 and $115,000 for the three and nine months ended March 31, 2008, respectively. At March 31, 2009 and June 30, 2008, the Company had accrued amounts of approximately $35,000 and $40,000, respectively, included in other accrued liabilities in the condensed consolidated balance sheets relating to this license and royalty agreement.

In March 2007, the Company entered into a license and royalty agreement with Deutsches Krebsforschungszentrum (DKFZ), a German cancer research center. Under this agreement, the Company has a non-exclusive license to use certain technology. The Company is obligated to pay DKFZ up to $12,500 for each CyberKnife system sold that includes the licensed

Table of Contents

technology, with the stipulation that the Company must make minimum annual payments of $50,000. Royalty expense under this agreement recorded in cost of revenue or deferred cost of revenue was $138,000 and $313,000 for the three and nine months ended March 31, 2009, respectively. Royalty expense under this agreement recorded in cost of revenue or deferred cost of revenue was $0 and $17,000 for the three and nine months ended March 31, 2008, respectively. At March 31, 2009 and June 30, 2008, the Company had accrued amounts of approximately $138,000 and $38,000, respectively, included in other accrued liabilities in the condensed consolidated balance sheets relating to this license and royalty agreement.

Contingencies

From time to time, the Company may become involved in litigation relating to claims arising from the ordinary course of business. Management does not believe the final disposition of these matters will have a material adverse effect on the financial position, results of operations or future cash flows of the Company.

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 recorded no liability associated with this indemnification, as it is not aware of any pending or threatened actions that are probable losses.

8. STOCK PLANS

In August 2007, the Company announced that the Board of Directors had approved a stock repurchase plan that authorized the Company to repurchase shares of its common stock. Under the plan, the Company has the ability to acquire up to $25.0 million of common shares in the open market over a period of one year. No shares were repurchased during the three and nine months ended March 31, 2009. As of March 31, 2009, the Company has repurchased 2,140,018 shares of its common stock for $24.0 million. Such shares were not retired nor returned to the status of authorized, unissued shares. Accordingly, such shares remain issued and classified as treasury stock as of March 31, 2009. The Company accounts for its treasury stock under the par value method. At March 31, 2009, the aggregate par value of the Company s treasury stock was immaterial. The stock repurchase plan expired in August 2008 and was not renewed by the Board of Directors.

Stock Option Plans

In 1993, the Company s stockholders approved the 1993 Stock Option Plan (the 1993 Plan). Under the 1993 Plan, the Board of Directors is authorized to grant options to purchase shares of common stock at fair value, as determined by the Board of Directors, to employees, directors and consultants for up to 1,744,268 shares.

In 1998, the Company s stockholders approved the 1998 Equity Incentive Plan (the 1998 Plan). Under the 1998 Plan, the Board of Directors is authorized to grant options to purchase shares of common stock to employees, directors and consultants for up to 14,100,000 shares.

In 2007, the Board of Directors approved the 2007 Incentive Award Plan (the 2007 Plan). Under the 2007 Plan, the Board of Directors is authorized to award stock-based grants to employees, directors, and consultants for up to 6,000,000 shares. As of March 31, 2009, the 1993 Plan and the 1998 Plan continued to remain in effect with respect to options previously granted under such plans; however, options can no longer be granted from the 1993 and 1998 Plans.

Only employees are eligible to receive incentive stock options. Non-employees may be granted non-qualified options. The Board of Directors has the authority to set the exercise price of all options granted, subject to the exercise price of incentive stock options being no less than 100% of the fair value of a share of common stock on the date of grant; and no less than 85% of the fair value for non-qualified stock options.

Generally, the Company s outstanding options vest at a rate of 25% per year. However, certain options granted to certain employees vest based upon performance. Continued vesting typically terminates when the employment or consulting relationship ends. The maximum term of the options granted to persons who own at least 10% of the voting power of all outstanding stock on the date of grant is 5 years. The maximum term of all other options is 10 years.

The aggregate intrinsic value in the table below represents the total pretax intrinsic value (the difference between the fair value of the Company s common stock as of the end of the reporting period of $5.20 and the exercise price for stock options) that would have been received by option holders if all options had been exercised on March 31, 2009. The total intrinsic value of options exercised during the three and nine months ended March 31, 2009 was approximately $672,000 and $2.4 million, respectively. The total intrinsic value of options exercised in the three and nine months ended March 31, 2008 was approximately $9.4 million and $27.1

Table of Contents

million, respectively. Cash received from option exercises for the three and nine months ended March 31, 2009 was $475,000 and $3.2 million, respectively. Cash received from option exercises for the three and nine months ended March 31, 2008 was $1.2 million and $3.6 million, respectively. Option activity during the nine months ended March 31, 2009 was as follows:

	Options outstanding	Weighted average exercise price	Weighted average remaining contractual life (years)	Aggregate intrinsic value as of March 31, 2009
Balance at June 30, 2008	9,212,831	$ 5.70		
Options granted	1,499,404	$ 6.58		
Options forfeited	(719,719)	$ 12.29		
Options exercised	(979,261)	$ 3.24		
Balance at March 31, 2009	9,013,255	$ 5.59	6.11	$ 16,614,987
Vested or Expected to vest at March 31, 2009	8,690,578	$ 5.46	6.00	$ 16,581,624
Exercisable at March 31, 2009	6,538,071	$ 4.18	5.05	$ 16,364,500

As of March 31, 2009, there was approximately $20.4 million of unrecognized compensation cost related to unvested stock options which is expected to be recognized over a weighted-average period of 2.2 years. The Company s current practice is to issue new shares to satisfy share option exercises. The total fair value of shares vested during the three and nine months ended March 31, 2009 was $2.2 million and $8.7 million, respectively. The total fair value of shares vested during the three and nine months ended March 31, 2008 was $2.8 million and $10.7 million, respectively.

The weighted average grant date fair values of options granted were $3.11 and $4.02 per share for the three and nine months ended March 31, 2009, respectively. The weighted average grant date fair values of options granted were $7.32 and $8.38 per share for the three and nine months ended March 31, 2008, respectively.

Employee Stock Purchase Plan

Under the ESPP, the Company is authorized to issue up to 1,545,889 shares of common stock. Qualified employees may purchase shares of common stock through payroll deductions at a price per share that is 85% of the lesser of the fair market value of the Company s common stock as of the beginning of an applicable offering period or the applicable purchase date, with purchases generally occurring every six months. Employees payroll deductions may not exceed 10% of their salary. Employees may purchase up to 2,500 shares per period provided that the value of the shares purchased in any calendar year may not exceed $25,000, as calculated pursuant to the purchase plan.

The ESPP was initiated in February 2007. As of March 31, 2009, there was approximately $161,000 of unrecognized compensation cost related to the ESPP, which is expected to be recognized over the next two months.

Restricted Stock Units

RSUs generally vest at a rate of 25% per year. However, certain RSUs granted to certain employees vest 10% upon the first anniversary year of the grant date, 20% upon the second anniversary year of the grant date, 30% upon the third anniversary year of the grant date and 40% upon the fourth anniversary year of the grant date. Continued vesting typically terminates when the employment relationship ends.

As of March 31, 2009, there was approximately $13.9 million of unrecognized compensation cost related to RSUs, which is expected to be recognized over a weighted-average period of 2.1 years. RSU activity for the nine months ended March 31, 2009 was as follows:

	Number of Shares	**Weighted Average Grant Date Fair Value**
Unvested resticted stock units at June 30, 2008	724,034	$ 23.43
Restricted stock units granted	154,905	$ 6.55
Forfeitures	(125,127)	$ 19.91
Releases	(165,353)	$ 5.98
Unvested resticted stock units at March 31, 2009	588,459	$ 19.04

Table of Contents

9. RELATED PARTY TRANSACTIONS

The Company recognized related party revenue of $229,000 and $423,000 during the three months ended March 31, 2009 and 2008, respectively, and $656,000 and $792,000 during the nine months ended March 31, 2009 and 2008, respectively, relating to products and services provided to Stanford. The Company s former Chief Executive Officer, Dr. John R. Adler, Jr., is an active member of the faculty at Stanford. Currently, he is a member of the Board of Directors and he holds the position of Professor of Neurosurgery and Radiation Oncology at Stanford. At March 31, 2009 and June 30, 2008, amounts of $484,000 and $231,000, respectively, were recorded as deferred revenue and advances relating to related party payments made by Stanford. At March 31, 2009 and June 30, 2008, no related party amounts were due from Stanford. The Company recorded $29,000 and $141,000 of expense during the three and nine months ended March 31, 2009, relating to research grants with Stanford to support customer studies related to the Company s CyberKnife systems. No amounts relating to research grants with Stanford were recorded during the three and nine months ended March 31, 2008. The Company also has a license agreement with Stanford as disclosed in Note 7.

In April 2008, the Company entered into a consulting agreement with Dr. Adler, whereby Dr. Adler was entitled to receive a maximum compensation of $167,100 per year, payable in quarterly installments at the beginning of each quarter beginning on April 1, 2008.

Subsequent to the end of the Company s third fiscal quarter, in April 2009, the Company entered into a new consulting agreement with Dr. Adler, which terminated the prior consulting agreements discussed above. Under the new consulting agreement, Dr. Adler is entitled to receive a maximum compensation of $168,100 per year, payable in quarterly installments at the beginning of each quarter beginning on April 1, 2009. This agreement has a term of one year and will renew for successive one-year periods, unless either party provides 30 days written notice of termination prior to the expiration of each one-year period. The Company recognized consulting expense for Dr. Adler of $42,000 and $125,000 for the three and nine months ended March 31, 2009, respectively, and $37,000 and $112,000 during the three and nine months ended March 31, 2008, respectively, pursuant to these agreements.

The Company recognized no related party revenue during the three and nine months ended March 31, 2009 relating to products and services provided to Meditec. The Company recognized $0 and $1.2 million during the three and nine months ended March 31, 2008, respectively, relating to products and services provided to Meditec. Meditec s parent, Marubeni Corporation, was a common stockholder of the Company. Marubeni Corporation transferred its interest in the Company during September 2007 and is no longer a stockholder of record of the Company as of March 31, 2009. At March 31, 2009 and June 30, 2008, no related party amounts were recorded as deferred revenue or advances relating to related party payments made by Meditec for products and services. At March 31, 2009 and June 30, 2008, no amounts were due from Meditec.

10. SECURED CREDIT LINE

In November 2008, the Company obtained a line of credit with UBS in conjunction with the Rights Agreement (see Note 3). The line of credit is due on demand and allows for borrowings of up to 75% of par value of the Company s ARS. The line of credit is secured by the Company s ARS, which have been pledged as Collateral. Advances under this agreement bear interest with interest payments payable monthly. No borrowings were outstanding at March 31, 2009.

To the extent that there are borrowings outstanding under the line of credit, the following provisions will apply. All interest, dividends, distributions, premiums, other income and payments received into the ARS investment account at UBS will be automatically transferred to UBS as payments on the line of credit. Additionally, proceeds from any liquidation, redemption, sale or other disposition of all or part of the ARS will be automatically transferred to UBS as payments. If these payments are insufficient to pay all accrued interest by the monthly due date, then UBS will either require the Company to make additional interest payments or, at UBS s discretion, capitalize unpaid interest as an additional advance. UBS s intent is to cause the interest rate payable by the Company to be equal to the weighted average interest or dividend rate payable to the Company on the ARS pledged as collateral. Upon cancellation of the line of credit, the Company will be reimbursed for any amount paid in interest on the line of credit that exceeds the income on the ARS.

Advances on this line of credit may be used to fund working capital requirements, capital expenditures or other general corporate purposes, except that they may not be used to purchase, trade or carry any securities or to repay debt incurred to purchase, trade or carry any securities.

Table of Contents

11. RESTRUCTURING

On January 29, 2009, the Company announced a Workforce Alignment Plan (Plan) to reduce headcount and improve efficiency and productivity. As a result of the Plan, the Company reduced its headcount by approximately 60 positions or approximately 13% of the Company s U.S. workforce. Most of the affected jobs were located at the Company s Sunnyvale, CA headquarters. All employees affected by the Plan were notified on January 28, 2009.

In connection with the Plan, the Company incurred employee severance expenses of approximately $1.6 million during the three and nine months ended March 31, 2009. The following table summarizes the severance expense activity, including payments of severance amounts accrued, which are included in accrued compensation in the condensed consolidated balance sheet, as of March 31, 2009 (in thousands):

Accrued severance as of January 28, 2009	$	1,509
Cash payments made in the third quarter of 2009		(769)
Severance expense recorded in the third quarter of 2009		87
Accrued severance as of March 31, 2009	$	827

12. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) includes net income (loss), unrealized gain (loss) on available-for-sale investments and foreign currency translation adjustments as follows (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2009	2008	2009	2008
Net income (loss)	$ 1,216	$		