ACCURAY INC
Form 10-Q
February 04, 2010
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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, 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 preceding 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 January 11, 2010, there were 57,740,069 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, 2009

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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, 2009 (Unaudited)	June 30, 2009
Assets		
Current assets:		
Cash and cash equivalents	$ 39,463	$ 36,835
Restricted cash	873	527
Short-term available-for-sale securities	74,504	64,634
Trading securities	22,011	
Accounts receivable, net of allowance for doubtful accounts of $24 and $484 at December 31, 2009 and June 30, 2009, respectively	37,433	36,427
Inventories	25,292	28,909
Prepaid expenses and other current assets	8,973	6,186
Deferred cost of revenue current	15,761	18,984
Total current assets	224,310	192,502
Long-term available-for-sale securities	14,254	35,245
Long-term trading securities		22,007
Deferred cost of revenue noncurrent	2,817	2,933
Property and equipment, net	12,502	15,066
Goodwill	4,495	4,495
Intangible assets, net	517	668
Other assets	1,622	1,470
Total assets	$ 260,517	$ 274,386
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 11,175	$ 14,941
Accrued compensation	8,737	10,119
Other accrued liabilities	9,608	5,649
Customer advances	13,577	13,185
Deferred revenue current	53,098	68,105
Total current liabilities	96,195	111,999
Long-term liabilities:		
Long-term other liabilities	697	708
Deferred revenue noncurrent	6,218	7,777
Total liabilities	103,110	120,484
Commitments and contingencies (Note 6)		
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: 59,847,863 and 58,783,547 shares at December 31, 2009 and June 30, 2009, respectively; outstanding: 57,707,845 and 56,643,529 shares at December 31, 2009 and June 30, 2009, respectively		58		57
Additional paid-in capital		282,048		273,946
Accumulated other comprehensive income		270		416
Accumulated deficit		(124,969)		(120,517)
Total stockholders equity		157,407		153,902
Total liabilities and stockholders equity	$	260,517	$	274,386

Condensed consolidated balance sheet at June 30, 2009 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,	
	2009	**2008**	**2009**	**2008**
Net revenue:				
Products	$ 35,686	$ 41,301	$ 66,032	$ 78,756
Shared ownership programs	456	876	937	1,912
Services	20,688	13,922	40,342	29,829
Other	491	1,538	585	2,997
Total net revenue	57,321	57,637	107,896	113,494
Cost of revenue:				
Cost of products	17,556	17,520	32,207	32,264
Cost of shared ownership programs	329	207	650	469
Cost of services	13,133	8,972	27,053	20,157
Cost of other	339	1,529	403	2,766
Total cost of revenue	31,357	28,228	60,313	55,656
Gross profit	25,964	29,409	47,583	57,838
Operating expenses:				
Selling and marketing	10,063	10,723	18,712	24,203
Research and development	7,769	8,794	15,431	17,548
General and administrative	10,430	9,259	19,360	19,692
Total operating expenses	28,262	28,776	53,503	61,443
Income (loss) from operations	(2,298)	633	(5,920)	(3,605)
Other income, net	426	748	911	1,861
Income (loss) before provision for (benefit from) income taxes	(1,872)	1,381	(5,009)	(1,744)
Provision for (benefit from) income taxes	(696)	31	(557)	85
Net income (loss)	$ (1,176)	$ 1,350	$ (4,452)	$ (1,829)
Net income (loss) per share:				
Basic net income (loss) per share	$ (0.02)	$ 0.02	$ (0.08)	$ (0.03)
Weighted average common shares used in computing basic net income (loss) per share	57,405	55,064	57,112	54,845
Diluted net income (loss) per share	$ (0.02)	$ 0.02	$ (0.08)	$ (0.03)
Weighted average common shares used in computing diluted net income (loss) per share	57,405	58,267	57,112	54,845

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,	
	2009	2008
Cash Flows From Operating Activities		
Net loss	$ (4,452)	$ (1,829)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	3,892	3,304
Stock-based compensation	6,354	8,552
Realized gain on investments	(2)	(3)
Unrealized loss on long-term trading securities, net of gain on put option	(227)	860
Provision for bad debts	(460)	168
Loss on write-down of inventories	2,162	1,478
Loss on disposal of property and equipment	18	66
Changes in assets and liabilities:		
Accounts receivable	(990)	(7,467)
Inventories	1,934	(3,340)
Prepaid expenses and other current assets	(3,119)	(2,204)
Deferred cost of revenue	2,804	9,199
Other assets	(161)	(45)
Accounts payable	(3,731)	(3,757)
Accrued liabilities	3,400	5,233
Customer advances	525	(6,524)
Deferred revenue	(16,416)	(16,387)
Net cash used in operating activities	(8,469)	(12,696)
Cash Flows From Investing Activities		
Purchases of property and equipment	(950)	(1,415)
Restricted cash	(394)	4,249
Purchase of investments	(36,651)	(76,079)
Sale and maturity of investments	47,850	74,656
Net cash provided by investing activities	9,855	1,411
Cash Flows From Financing Activities		
Proceeds from issuance of common stock	1,066	2,698
Proceeds from employee stock purchase plan	872	806
Excess tax benefit from stock-based compensation	(498)	
Net cash provided by financing activities	1,440	3,504
Effect of exchange rate changes on cash	(198)	218
Net increase (decrease) in cash and cash equivalents	2,628	(7,563)
Cash and cash equivalents at beginning of period	36,835	36,936
Cash and cash equivalents at end of period	$ 39,463	$ 29,373

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 (the Company) designs, develops and sells the CyberKnife system (CyberKnife), which is an image-guided robotic radiosurgery system used for the treatment of solid tumors anywhere in the body.

The Company is incorporated in Delaware, USA and has eleven 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, 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, Accuray Medical Equipment GmbH, located in Munich, Germany and Accuray Tibbi Cihazlar Ve Malzemeler Ithalat Ihracat Anonim Sirketi, located in Istanbul, Turkey. The purpose of these subsidiaries is to market and service the Company s products in the respective countries in which they are located.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Fiscal Year

On June 23, 2009, the Company prospectively changed its fiscal year end from the Saturday closest to June 30, to June 30. Beginning with the fiscal year ended June 30, 2010 (fiscal 2010), the Company s fiscal quarters end on September 30, December 31, March 31 and June 30.

Basis of Presentation and Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its subsidiaries and the Company s variable interest entity, Morphormics, Inc. (Morphormics). The Company is considered the primary beneficiary of Morphormics. All significant inter-company transactions and balances have been eliminated in consolidation. Certain prior period balances have been reclassified to conform to the current period presentation.

The accompanying condensed consolidated balance sheet as of December 31, 2009 and the condensed consolidated statements of operations for the three and six-month periods ended December 31, 2009 and 2008 and the condensed consolidated statements of cash flows for the six-month periods ended December 31, 2009 and 2008 and other information disclosed in the related notes are unaudited. The condensed consolidated balance sheet as of June 30, 2009 was derived from the Company s audited consolidated financial statements at that date. The accompanying condensed consolidated 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, 2009 filed with the Securities and Exchange Commission (the SEC).

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 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 Company has evaluated subsequent events through February 4, 2010, which is the date that the unaudited condensed consolidated financial statements were issued. The results for the three and six months ended December 31, 2009 are not necessarily indicative of the results to be expected for the year ending June 30, 2010 or for any other interim period or for any future year.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures at the date of the financial statements. Actual results could differ from those estimates.

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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 excluded from the determination of net loss 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, net, in the Company s condensed consolidated statements of operations.

The majority of the Company s executed sales contracts are denominated in U.S. dollars. The CyberKnife system sales contracts denominated in local currency are direct end customer transactions for international customers. At December 31, 2009, there was one sales contract for CyberKnife system denominated in foreign currency, which was recorded in deferred revenue in the accompanying condensed consolidated balance sheets.

Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less on the date of purchase to be cash equivalents. Cash equivalents consist of amounts invested in highly liquid investment accounts and money market accounts.

Restricted Cash

Restricted cash includes amounts deposited as collateral per the terms of contracts with customers requiring that deposited cash amounts be secured via letters of credit until delivery of the CyberKnife unit occurs.

Marketable Securities

The Company s available-for-sale securities on the condensed consolidated balance sheets include commercial paper, corporate debt and debt issued by U.S. government sponsored enterprises. All marketable securities designated as available-for-sale are reported at estimated fair value, with unrealized gains and losses recorded in stockholders equity and included in accumulated other comprehensive income. Realized gains and losses on the sale of available-for-sale marketable securities are recorded in other income, net. 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 of one year or less are classified as short-term available-for-sale marketable securities. Available-for-sale marketable securities with remaining maturities of greater than one year are classified as long-term available-for-sale marketable securities. The Company has the ability and the intent to hold these securities for a period of time sufficient to allow for any anticipated recovery in market value.

The Company s trading securities on the condensed consolidated balance sheets consist of (i) auction-rate securities (ARS) that 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, net.

Interest, dividends, amortization and accretion of purchase premiums and discounts on all of the Company s marketable securities are included in other income, net.

Other-than-Temporary Impairment Assessment

The Company regularly reviews all of its investments for other-than-temporary declines in fair value. The review includes but is not limited to (i) the consideration of the cause of the impairment, (ii) the creditworthiness of the security issuers, (iii) the length of time a security is in an unrealized loss position, and (iv) the Company s ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.

Concentration of Credit Risk and Other Risks and Uncertainties

The Company s cash and cash equivalents are mainly deposited with three 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.

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For the three and six months ended December 31, 2009 and 2008, there were no customers that represented 10% or more of total revenue. The following summarizes the accounts receivable from customers in excess of 10% of total accounts receivable:

	December 31, 2009	June 30, 2009
Customer A		11%
Customer B		10%
Customer C	12%	
Customer D	12%	

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.

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 the 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 consulting. 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.

The Company recognizes product revenues for sales of the CyberKnife system, optional 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. 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.

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 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, or (2) establishment of VSOE of fair value for all remaining undelivered elements.

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.

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. Once all such upgrade obligations have been delivered, all accumulated and 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 originally 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.

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CyberKnife sales with nonlegacy service plans

In fiscal year 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 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 units 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 upgrades 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 units where revenue recognition has been deferred. In those cases, the costs are deferred and are recognized over the period of revenue recognition.

Distributor sales

Sales to third party distributors are evidenced by a distribution agreement governing the relationship together with binding purchase orders or signed quotation 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 sell-through of the product to the end user customer and once all other revenue recognition criteria are met including completion of all obligations under the terms of the purchase order or signed quotation. 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 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.

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 CyberKnife 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.

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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 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.

The CyberKnife systems associated with the Company s shared ownership program are recorded within property and equipment. Effective April 1, 2009, the estimated useful life of the Company s placement units was reduced from ten to seven years due to a change in management s estimate. Depreciation and warranty expenses attributable to the CyberKnife shared ownership systems are recorded within cost of shared ownership program.

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 method. The Company recognizes any loss provisions from the total contract in the period such loss is identified.

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 contractual service period, usually one year. Service revenue is recognized ratably over the service period. 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 manufacturing of units, direct service costs for which the revenue has been deferred in accordance with the Company s revenue recognition policies, and deferred costs associated with the Japan upgrade services. Deferred revenue, and associated deferred cost of revenue, expected to be realized within one year are classified as current liabilities and current assets, respectively.

Goodwill and Other Purchased Intangibles

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. Goodwill and other intangible assets resulted from the Company s January 2005 acquisition of the High Energy Systems Division (HES) of American Science and Engineering, Inc. (AS&E). The Company integrated this operation into its existing manufacturing operation. HES had been the sole source manufacturer of the linear accelerator used in the CyberKnife system. The Company performs an annual test for impairment of goodwill and intangible assets with indefinite lives, and interim tests if indications of potential impairment exist. As of December 31, 2009, there were no indicators of impairment.

Stock-Based Compensation

The Company recognizes stock-based compensation expense by estimating the fair value of each stock option, restricted stock unit award (RSU), or stock issuance through the Company s employee stock purchase plan (ESPP), on the date of grant using the Black-Scholes option-pricing model. The fair market value of the Company s common stock was calculated at the date of grant by its closing market price as published by the Nasdaq Global Market. 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 expected term for stock issuances under the ESPP was based upon the offering period of the ESPP. The risk-free interest rate for the expected term of the option award or issuance was based on the U.S. Treasury Constant Maturity rate. The Company s forfeiture rate is estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Our estimated annual forfeiture rates are based on our historical forfeiture experience.

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,

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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 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. Management does not believe there will be any material changes in the unrecognized tax benefits within the next 12 months.

Net Income (Loss) Per Common Share

Basic net income (loss) per common share is calculated based on the weighted-average number of shares of our common stock outstanding during the period. Diluted net income (loss) per common share is calculated based on the weighted-average number of shares of our common stock outstanding and other dilutive securities outstanding during the period. The potential dilutive shares of our common stock resulting from the assumed exercise of outstanding stock options and equivalents are determined under the treasury stock method. Shares used in the computation on net income (loss) per common share are as follows:

	Three Months Ended December 31,		**Six Months Ended December 31,**	
	2009	**2008**	**2009**	**2008**
Weighted-average shares - basic	57,405,241	55,064,326	57,112,352	54,844,804
Effect of dilutive securities:				
Stock options and restricted stock units		3,202,927		
Weighted-average shares - diluted	57,405,241	58,267,253	57,112,352	54,844,804

For the three months ended December 31, 2008, 4,251,699 common stock equivalents were not included in dilutive shares as their effect is anti-dilutive.

Comprehensive Income (Loss)

Comprehensive income (loss) is comprised of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) consists of foreign currency translation adjustments and unrealized gains and losses on investments that have been excluded from the determination of net income (loss). Comprehensive income (loss) for the three and six months ended December 31, 2009 and 2008 is as follows (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
Net income (loss)	$ (1,176)	$ 1,350	$ (4,452)	$ (1,829)
Unrealized gain (loss) on investments	(124)	3,369	(147)	1,613
Foreign currency translation adjustments	(13)	(9)	1	(7)
Comprehensive income (loss)	$ (1,313)	$ 4,710	$ (4,598)	$ (223)

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.

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The Company markets its products in the United States and internationally through its direct sales force and indirect distribution channels. Revenue by geographic region is based on the shipping addresses of the Company s customers. The following summarizes revenue by geographic region (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
Americas (including Puerto Rico)	$ 45,256	$ 35,564	$ 75,882	$ 77,816
Europe	8,460	10,853	25,089	12,526
Asia (excluding Japan)	868	8,661	1,593	14,754
Japan	2,737	2,559	5,332	8,398
Total	$ 57,321	$ 57,637	$ 107,896	$ 113,494

Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-06, *Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06 amends FASB Accounting Standards Codification (ASC) 820 and clarifies and provides additional disclosure requirements related to recurring and non-recurring fair value measurements and employers disclosures about postretirement benefit plan assets. This ASU is effective for interim and annual reporting periods beginning after December 15, 2009. The adoption of ASU 2010-06 is not expected to have a material impact on the Company s condensed consolidated financial statements.

In October 2009, the FASB issued ASU 2009-13, *Multiple-Deliverable Revenue Arrangements,* (amendments to ASC Topic 605, *Revenue Recognition*) (ASU 2009-13) (formerly Emerging Issues Task Force Issue 08-1) and ASU 2009-14, *Certain Arrangements That Include Software Elements*, (amendments to FASB ASC Topic 985, *Software*) (ASU 2009-14) (formerly Emerging Issues Task Force Issue 09-3). ASU 2009-13 requires entities to allocate revenue in an arrangement using estimated selling prices of the delivered goods and services based on a selling price hierarchy. The amendments eliminate the residual method of revenue allocation and require revenue to be allocated using the relative selling price method. ASU 2009-14 removes tangible products from the scope of software revenue guidance and provides guidance on determining whether software deliverables in an arrangement that includes a tangible product are covered by the scope of the software revenue guidance. ASU 2009-13 and ASU 2009-14 should be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. The Company anticipates adopting ASU 2009-13 and ASU 2009-14 in fiscal 2011 and is currently assessing the impact of the adoption of ASU 2009-13 or ASU 2009-14 on the Company s condensed consolidated financial statements.

In June 2009, the FASB issued ASC 810-10, *Consolidation of Variable Interest Entities* (ASC 810-10) (formerly SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*). ASC 810-10 eliminates the quantitative approach previously required for determining the primary beneficiary of a variable interest entity and to require ongoing qualitative reassessments of whether an enterprise is the primary beneficiary of a variable interest entity. ASC 810-10 requires additional disclosures about an enterprise s involvement in variable interest entities. ASC 810-10 is effective as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The adoption of ASC 810-10 is not expected to have a material impact on the Company s condensed consolidated financial statements.

In June 2009, the FASB issued ASC 860-10, *Transfers and Servicing* (ASC 860-10) (formerly SFAS No. 166, *Accounting for Transfers of Financial Assets, an amendment to SFAS No. 140)*. The new standard eliminates the concept of a qualifying special-purpose entity, changes the requirements for derecognizing financial assets, and requires additional disclosures in order to enhance information reported to users of financial statements by providing greater transparency about transfers of financial assets, including securitization transactions, and an entity s continuing involvement in and exposure to the risks related to transferred financial assets. ASC 860-10 is effective for fiscal years beginning after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. The adoption of ASC 860-10 is not expected to have a material impact on the Company s condensed consolidated financial statements.

3. FINANCIAL INSTRUMENTS

The Company is permitted 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, enables 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

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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 for up to 75% of par value of the ARS as determined by UBS until June 30, 2010 (See Note 9).

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 trading securities on the accompanying condensed consolidated balance sheets.

Due to UBS s ability to sell the ARS at any time under the Rights Agreement, the ARS previously reported as available-for-sale have been transferred to trading securities on the condensed consolidated balance sheets. 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 additional net unrealized gains of $3.1 million relating to the change in fair value of the trading securities from November 2008 through December 31, 2009 in Other income, net . At December 31, 2009 and June 30, 2009, the total fair value of the ARS was $21.4 million and $20.7 million, respectively, net of $0.7 million and $1.7 million, respectively, of unrealized losses.

Additionally, the Company recorded unrealized gains of $3.3 million related to the fair value of the put option at the time it entered into the Rights Agreement and recorded unrealized losses relating to the change in fair value of the put option beginning in November 2008. During the three and six months ended December 31, 2009, the Company recorded a total unrealized loss of $0.3 million and $0.8 million, respectively, for a total fair value of the put option of $0.6 million as of December 31, 2009. During the three and six months ended December 31, 2008, the Company recorded a total unrealized loss of $0.1 million for a total fair value of the put option of $3.3 million as of December 31, 2008. During the three and six months ended December 31, 2009, $0.4 million and $1.0 million, respectively, of unrealized gain in fair value of the ARS resulted in a net unrealized gain of $0.1 million and $0.2 million, respectively, to Other income, net During the three and six months ended December 31, 2008, $0.8 million of total unrealized loss in fair value of the ARS resulted in a total net unrealized loss of $0.9 million to Other income, net . During the three and six months ended December 31, 2009, UBS redeemed $0.1 million and $0.2 million, respectively, of the ARS, which generated realized gains that were not material. During the three and six months ended December 31, 2008, UBS did not redeem any of the ARS.

The Company defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy contains three levels of inputs that may be used to measure fair value, as follows:

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

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

• Quoted prices for similar assets or liabilities in active markets;

• Quoted prices for identical or similar assets in non-active markets;

• Inputs other than quoted prices that are observable for the asset or liability; and

• Inputs that are derived principally from or corroborated by other observable market data.

Level 3 Unobservable inputs that cannot be corroborated by observable market data and 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.

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The following tables 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 December 31, 2009 and June 30, 2009, according to the valuation techniques the Company used to determine their fair values (in thousands):

	Fair Value at December 31, 2009	Level 1	Fair Value Measurements Using Inputs Considered as Level 2	Level 3
Money market funds	$ 15,008	$ 15,008	$	$
Corporate notes	30,504		30,504	
Commercial paper	25,369		25,369	
U.S. government and governmental agency obligations	32,885		32,885	
Auction-rate securities	21,441			21,441
Put option	570			570
Total	$ 125,777	$ 15,008	$ 88,758	$ 22,011

	Fair Value at June 30, 2009	Level 1	Fair Value Measurements Using Inputs Considered as Level 2	Level 3
Money market funds	$ 19,549	$ 19,549	$	$
Corporate notes	27,251		27,251	
Commercial paper	21,865		21,865	
U.S. government and governmental agency obligations	50,763		50,763	
Auction-rate securities	20,669			20,669
Put option	1,338			1,338
Total	$ 141,435	$ 19,549	$ 99,879	$ 22,007

Investments in marketable securities classified as available-for-sale by security type at December 31, 2009 and June 30, 2009, consisted of the following (in thousands):

	December 31, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term investments:				
Commercial paper	$ 25,357	$ 12	$	$ 25,369
US Corporate debt	23,114	156	(1)	23,269
Government-sponsored enterprises	25,805	66	(5)	25,866
Total short-term investments	74,276	234	(6)	74,504
Long-term investments:				
US Corporate debt	7,161	74		7,235
Government-sponsored enterprises	7,000	19		7,019
Total long-term investments	14,161	93		14,254
Total short and long-term investments	$ 88,437	$ 327	$ (6)	$ 88,758

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	June 30, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term investments:				
Commercial paper	$ 21,869	$ 14	$ (18)	$ 21,865
US Corporate debt	9,993	81		10,074
Government-sponsored enterprises	32,456	239		32,695
Total short-term investments	64,318	334	(18)	64,634
Long-term investments:				
US Corporate debt	17,094	103	(20)	17,177
Government-sponsored enterprises	18,001	67		18,068
Total long-term investments	35,095	170	(20)	35,245
Total short and long-term investments	$ 99,413	$ 504	$ (38)	$ 99,879

All of the Company s investments with continuous unrealized losses have been in an unrealized loss position for less than twelve months at December 31, 2009. The Company has determined that the gross unrealized losses on its marketable securities at December 31, 2009 were temporary in nature.

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). 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 (in thousands).

	Three Months Ended December 31, 2009	Six Months Ended December 31, 2009
Beginning balance	$ 22,045	$ 22,007
Realized gain on auction rate securities included in earnings (1)	3	5
Unrealized gain on auction rate securities included in earnings (1)	408	992
Redemption of auction rate securities	(125)	(225)
Unrealized loss on put option included in earnings (1)	(320)	(768)
Balance at December 31, 2009	$ 22,011	$ 22,011

(1) Represents the amount of total gains (losses) for the period included in earnings relating to assets still held on December 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 consolidated balance sheets.

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 sheets. 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 170 days. The entire $25.4 million and $21.9 million held as of December 31, 2009 and June 30, 2009, respectively, in commercial paper are classified as short-term marketable securities on the Company s condensed consolidated balance sheets. 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.

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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 that generally mature within 2 years. These are classified as short-term and long-term marketable securities on the Company s condensed consolidated balance sheets. 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 December 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 December 31, 2008, the Company determined Level 3 fair value using an income approach. 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 the lesser of (i) an average trailing twelve month yield for the ARS that is equal to the average trailing twelve month 91-day U.S. Treasury rate plus 1.20% or 1.50% premium according to provisions outlined in each security s agreement, (ii) the one-month LIBOR rate as of the auction date plus 1.5%, or (iii) a maximum interest rate of either 17% or 18% (specific to each ARS). 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 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 five 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 five years and the ARS with an estimated time to liquidity of one year as the put option allows for the acceleration of liquidity and the avoidance of a below market coupon rate over the one year time period.

4. BALANCE SHEET COMPONENTS

Accounts receivable, net

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

	December 31, 2009	June 30, 2009
Accounts receivable	$ 33,948	$ 36,539
Unbilled fees and services	3,509	372
	37,457	36,911
Less: Allowance for doubtful accounts	(24)	(484)
Accounts receivable, net	$ 37,433	$ 36,427

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Inventories

Inventories consist of the following (in thousands):

	December 31, 2009	June 30, 2009
Raw materials	$ 12,160	$ 12,172
Work-in-process	9,203	13,006
Finished goods	3,929	3,731
Total inventories	$ 25,292	$ 28,909

Property and Equipment, net

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

	December 31, 2009	June 30, 2009
Furniture and fixtures	$ 3,655	$ 3,404
Computer and office equipment	8,348	7,982
Leasehold improvements	7,682	7,676
Machinery and equipment	14,337	14,097
CyberKnife shared ownership systems	3,760	3,725
	37,782	36,884
Less: Accumulated depreciation and amortization	(25,280)	(21,818)
Property and equipment, net	$ 12,502	$ 15,066

Depreciation and amortization expense related to property and equipment for the three and six months ended December 31, 2009 was $2.0 million and $3.7 million, respectively. Depreciation and amortization expense related to property and equipment for the three and six months ended December 31, 2008 was $1.6 million and $3.2 million, respectively. Accumulated depreciation related to the CyberKnife systems attributable to the shared ownership program as of December 31, 2009 and June 30, 2009 was $1.7 million and $1.0 million, respectively.

5. INVESTMENT

On July 29, 2008, the Company and 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 Company is deemed to be Morphormics primary beneficiary; therefore, it would absorb a majority of expected losses. The Company consolidates Morphormics in its financial results. The consolidation of Morphormics assets and liabilities did not have a material effect on the Company s consolidated balance sheets at December 31, 2009 or June 30, 2009. Subsequent to July 29, 2008, the Company has recorded cumulative losses of $1.3 million on its investment in Morphormics. The remaining $0.2 million of the Company s investment remains at risk as of December 31, 2009.

In July 2009, Morphormics entered into a promissory note (Note) with a third party and received loan proceeds of $200,000. The Note bears interest at a rate of 5.5% per annum, compounded monthly. Fifty percent of the Note principal becomes due within thirty days of Morphormics deriving gross proceeds from the sale of a product. The remaining Note principal and all accrued interest is payable upon the earlier of: 1) thirty days of Morphormics receiving a payment from the Company associated with a purchase commitment, or 2) July 1, 2012. At December 31, 2009, Morphormics paid off all outstanding amounts under the Note.

6. CONTINGENCIES

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 have

been consolidated. All of these complaints generally allege that the Company and the individual defendants made false or misleading public statements regarding the Company s operations and seek unspecified monetary damages and other relief.

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On August 5, 2009, a shareholder derivative lawsuit was filed in Santa Clara County Superior Court against certain of the Company s current and former officers and directors. The Company is named as a nominal defendant. The complaint generally alleges that the defendants breached their fiduciary duties by misrepresenting and/or failing to disclose material information regarding the Company s business and financial performance, and seeks unspecified monetary damages and other relief.

On September 3, 2009, Best Medical International, Inc. (Best Medical) filed a lawsuit against the Company claiming the Company 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. They are seeking monetary 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.

On November 24, 2009, a shareholder derivative lawsuit was filed in the U.S. District Court for the Northern District of California against certain of the Company s current and former officers and directors. The Company is named as a nominal defendant. Two other shareholder derivative lawsuits were filed in the same court on November 30, 2009 and December 1, 2009. These three actions have been consolidated. The consolidated complaint generally alleges that the defendants breached their fiduciary duties by misrepresenting and/or failing to disclose material information regarding the Company s business and financial performance, and that certain defendants also violated the federal securities laws. The consolidated complaint seeks unspecified monetary damages and other relief.

As of December 31, 2009, the Company has not recorded any liabilities for the above referenced lawsuits as a loss is not considered probable or estimable.

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 as of December 31, 2009.

7. STOCK-BASED COMPENSATION

The following table summarizes the stock-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,	
	2009	2008	2009	2008
Cost of revenue	$ 445	$ 547	$ 676	$ 1,179
Selling and marketing	655	935	1,463	1,980
Research and development	653	751	1,301	1,533
General and administrative	1,496	1,348	2,914	3,860
	$ 3,249	$ 3,581	$ 6,354	$ 8,552

At December 31, 2009 and June 30, 2009, capitalized stock-based compensation costs of $352,000 and $456,000, respectively, were included as components of inventory.

8. RELATED PARTY TRANSACTIONS

The Company s former Chief Executive Officer, Dr. John R. Adler, Jr. was a member of the Company s Board of Directors until his resignation effective July 19, 2009, and is an active member of the faculty at Stanford, where he holds the position of Professor of Neurosurgery and Radiation Oncology. Effective July 20, 2009, Dr. Adler was no longer a related party of the Company.

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The Company recognized related party revenue of $229,000 and $427,000 during the three and six months ended December 31, 2008, respectively, relating to products and services provided to Stanford. The Company recorded $29,000 and $57,000 of expense during the three and six months ended December 31, 2008, respectively, relating to research grants with Stanford to support customer studies related to the Company s CyberKnife systems. At June 30, 2009, $209,000 was recorded as deferred revenue and advances relating to related party payments made by Stanford. At June 30, 2009, $9,000 was due from Stanford.

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.

In April 2009, the Company entered into a new consulting agreement with Dr. Adler, which terminated the prior consulting agreement 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; however, the Company has received notice from Dr. Adler of his termination of this agreement, effective March 20, 2010. The Company recognized consulting expense for Dr. Adler in the amount of $42,000 and $84,000 for the three and six months ended December 31, 2008.

9. 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 during the three or six months ended December 31, 2009.

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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, 2009 and results of operations for the three and six months ended December 31, 2009 and 2008 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 that involve risks, uncertainties and assumptions. We urge you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. All forward-looking statements included in this report are based on information available to us on the date of this report, and we assume no obligation to update any forward-looking statements contained in this report. These forward-looking statements involve risks and uncertainties, and 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 annual report on Form 10-K for the fiscal year ended June 30, 2009 and supplemented by the Risk Factors set forth in Part II, Item 1A of this quarterly report on Form 10-Q. We encourage you to read those sections carefully.

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

Overview

We have developed the first and only commercially available intelligent robotic radiosurgery system, the CyberKnife system, designed to treat solid tumors anywhere in the body as an alternative to traditional surgery. The CyberKnife system combines continuous image-guidance technology with a compact linear accelerator that has the ability to move in three dimensions according to the treatment plan. Our image-guidance technology enables the system to continuously acquire images to track a tumor s location and transmit any position corrections to the robotic arm prior to delivery of each dose of radiation. Our compact linear accelerator (linac) is a compact radiation treatment device that uses microwaves to accelerate electrons to create high-energy X-ray beams to destroy the tumor. This combination, which we refer to as intelligent robotics, extends the benefits of radiosurgery to the treatment of tumors anywhere in the body. The CyberKnife system autonomously tracks, detects and corrects for tumor and patient movement in real-time during the procedure, enabling delivery of precise, high dose radiation typically with sub-millimeter accuracy. The CyberKnife procedure requires no anesthesia, can be performed on an outpatient basis and allows for the treatment of patients who otherwise would not have been treated with radiation or who may not have been good candidates for surgery. In addition, the CyberKnife procedure is designed to avoid many of the potential risks and complications that are associated with other treatment options and is more cost effective than traditional surgery.

In July 1999, we obtained 510(k) clearance from the United States Food and Drug Administration, or FDA, to market the CyberKnife system for the treatment of tumors and certain other conditions in the head, neck and upper spine. In August 2001, we received FDA clearance for the treatment of tumors anywhere in the body where radiation treatment is indicated. In September 2002, we received a CE mark for the sale of the CyberKnife system in Europe. We received approval for full-body treatment in Japan in June 2008; previously our CyberKnife regulatory approvals in Japan were limited to treatment for indications in the head and neck. The CyberKnife system has also been approved for various indications in Korea, Taiwan, China and other countries. To date, our CyberKnife system has been used to deliver more than 80,000 patient treatments.

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 Paris, France, Hong Kong, China, Tokyo, Japan, Madrid, Spain, New Delhi, India, Singapore, Moscow, Russia, Munich, Germany, Istanbul, Turkey and London, UK. As of December 31, 2009, we had 47 employees in our sales organization.

Our CyberKnife systems are either sold to our customers or placed with our customers pursuant to our shared ownership program. As of December 31, 2009, we had 190 CyberKnife systems installed at customer sites, including 187 sold and three pursuant to our shared ownership program. Of the 190 systems installed, 124 are in the Americas, 42 are in Asia and 24 are in Europe.

In addition to selling the CyberKnife system to customers through direct sales, we offer alternative arrangements to customers who may not have the financial means to purchase a CyberKnife system. For example, under our shared ownership program, we retain title to the CyberKnife system while the customer has use of the system. Our shared ownership contracts generally require a minimum monthly payment from the customer, and we may earn additional revenue through the use of the system at the site. Generally, minimum monthly payments are equivalent to the revenue generated from treating three to four patients per month, and any revenue received from additional patients is shared between us and the customer. We expect to continue to offer our shared ownership program to new customers. The shared ownership program typically has a term of five years, during which the customer has the option to purchase the system at pre-determined prices.

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We manufacture and assemble our CyberKnife systems at our manufacturing facility in Sunnyvale, California. We purchase major components, including the robotic manipulator, the treatment table or robotic couch, the magnetron, which creates the microwaves for use in the linear accelerator, the imaging cameras and the computers, from outside suppliers, some of which are single source. Our reliance on single source suppliers could harm our ability to meet demand for our products in a timely and cost effective manner. However, in most cases, if a supplier were unable to deliver these components, we believe that we would be able to find other sources for these components subject to any regulatory qualifications, if required. We manufacture certain other electronic and electrical subsystems, including the linear accelerator. We then assemble and integrate these components with our proprietary software and perform testing prior to shipment to customer sites.

We generate revenue from sales of products and by providing ongoing services and upgrades to customers following installation of the CyberKnife system. The current United States price for the CyberKnife system typically includes initial training, installation, and a one-year warranty. We also offer optional hardware and software when and if available, technical enhancements and upgrades to the CyberKnife system, as part of our multiyear service plans. Currently, our most comprehensive service plan is our Diamond Elite multiyear service plan, or Diamond plan. Under our Diamond plan, customers are eligible to receive up to two upgrades per year, when and if available. Prior to introducing our Diamond plan, we offered our Platinum service plan which provided specified future upgrade obligations. For systems sold with a Platinum service plan, all revenue, including CyberKnife product and service revenue, is deferred until all upgrade obligations have been satisfied and then is recognized ratably over the remaining life of the Platinum service contract. As of December 31, 2009, 148 of our customers had purchased service plans.

The CyberKnife procedure is currently covered and reimbursed by Medicare and other governmental and non-governmental third-party payors. Medicare coverage currently exists in the hospital outpatient setting and in the free-standing clinic setting. For calendar year 2010, the national unadjusted average Medicare payment rates under Healthcare Common Procedure Coding System, or HCPCS, are $3,572 under code G0339, the billing code for the first treatment, and $2,488 under code G0340, the billing code for each of the second through fifth treatments, approximately six percent and four percent less than 2009 payment rates, respectively. Payment for the free-standing clinic setting is governed by the final Medicare Physician Fee Schedule. For 2010, payment for CyberKnife procedures in the freestanding clinic settings for first and subsequent treatments is set by local Medicare carriers and rates may vary from low payment to a payment rate exceeding the hospital outpatient payment rates.

In addition to Medicare reimbursement to hospitals and clinics, physicians receive reimbursement for their professional services in the hospital outpatient setting and the free-standing clinic setting. Payment to physicians is based on the Medicare Physician Fee Schedule, and payment amounts are updated on an annual basis. For 2010, Medicare adjusted reimbursement rates for the Current Procedural Terminology, or CPT, code series describing the surgeon s role in the delivery of CyberKnife cranial and spinal procedures beginning with 61796 and 63620 to varying degrees. For example, the rate for treating five simple cranial lesions was reduced by less than one percent, and the rate for treating one complex cranial lesion was increased by more than 40%. Radiosurgery procedures in other anatomies require other surgeons to bill unlisted CPT codes with no assigned payment rates. Payment rates for unlisted codes are set by the local Medicare carrier and rates may vary from no payment to rates equivalent to the comparable CPT rates for the series beginning with 61796 and 63620. Coding for other physicians (primarily radiation oncologists) involved in the delivery of CyberKnife treatment increased by one percent.

In November of 2009, we announced the introduction of the CyberKnife VSI system, which allows physicians to perform conventionally fractioned robotic image guided intensity-modulated radiation therapy, or Robotic IMRT, in addition to Robotic Stereotactic Radiosurgery procedures. Reimbursement for Robotic IMRT is expected to be similar to conventional IMRT.

Our future success will depend in large part on our ability to maintain and increase our position in the market. To compete successfully, we will need to continue to demonstrate the advantages of our products and technologies over alternative procedures, products and technologies, and convince physicians and other healthcare decision makers of the advantages of our products and technologies. Our business and sales and

installation cycle does not immediately create recognizable revenue. As such, we must invest in sales and marketing activities up to 24 months prior to realizing the revenue from those activities. Our ability to achieve and maintain long-term profitability is largely dependent on our ability to successfully market and sell the CyberKnife system and to control our costs and effectively manage our growth.

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Financial Condition

Direct Sales and Installation Cycle

The CyberKnife system has a relatively long sales and installation cycle because it is a major capital item and requires the approval of senior management at purchasing institutions. The typical sales and installation cycle is up to 24 months in duration and involves multiple steps. Initial steps may include pre-selling activity followed by sales presentations and other sales related activities. The last step in the sales and installation cycle is installation of the CyberKnife system. Prior to installation, a purchasing institution must typically obtain a radiation device installation permit, and in some cases, a certificate of need or CON, both of which must be granted by state and local government bodies. Recently, as a result of healthcare cost considerations and sensitivity to the cost of major capital equipment items, some state CON boards have become more aggressive in the evaluation of CON applications. This trend, if it continues, may make the CON process more protracted and uncertain. In addition, the purchasing institution must build a radiation shielded facility or upgrade an existing facility to house the CyberKnife system. We typically receive a deposit at the time the terms agreement or full purchase agreement is entered into, or shortly thereafter, and the remaining balance for the sale of the CyberKnife system upon delivery and installation. The customer also typically selects a service plan at the time of signing a CyberKnife system terms agreement and enters into the service plan agreement prior to installation of the system.

Upon installation, we typically recognize the CyberKnife system sale price less the fair value of one year of service and training. We recognize the fair value of the first year of service as revenue pro rata over the twelve months following installation and training as delivered. In addition, if the customer has purchased our Diamond plan and assuming annual renewals, we would receive payment at the beginning of each of the second, third, fourth and fifth years of the multiyear service plan and recognize that revenue pro rata over each year.

Legacy Service Plans

Prior to introducing our Diamond plan, we offered a Platinum Elite multiyear service plan (Platinum plan). This legacy service plan was structured so that we have an obligation to deliver two upgrades per year over the course of the multiyear service plan. If we fail to deliver the upgrades, our customers are entitled to receive a refund of up to $100,000 for each upgrade not offered. To date, no refunds have been required pursuant to the Platinum plan. Beginning in November 2005, we phased out offering this legacy service plan to new customers.

The Platinum plan obligates us to deliver up to two upgrades per year during the term of the contract. We have not established fair value for those future obligations; hence, generally accepted accounting principles in the United States (GAAP) requires that we cannot begin to recognize any of the revenue or cost of sales derived from the sale of the CyberKnife system or the associated service plan until all upgrade obligations have been fulfilled. Therefore, the payments made by our customers who have our legacy Platinum plan are categorized as deferred revenue. Once we fulfill all upgrade obligations with respect to a specific Platinum plan, we ratably recognize the revenue and related cost of sales from the sale of the CyberKnife system and the Platinum plan over the remaining life of the contract.

Upgrades

Customers may purchase additional upgrades as optional extras prior to the delivery of all originally specified products and/or upgrade obligations. Such additional upgrades are considered elements of the original arrangement and associated revenues are deferred until the earlier of: (1) delivery of all elements, or (2) establishment of vendor specific objective evidence (VSOE) of fair value for all undelivered elements. Sales of additional upgrades after delivery of all specified upgrade obligations, as stated in the original contract, are considered separate arrangements and are recognized once all revenue recognition criteria applicable to the separate arrangements are met.

Warranty

All customers purchasing a CyberKnife system receive up to a two-year warranty included in the support agreement. In circumstances where we have VSOE of fair value for all undelivered elements, we recognize the CyberKnife system purchase price minus the fair value of support upon installation, and we recognize the value of one year of support ratably over the twelve months following installation.

Shared Ownership Program Revenue

As of December 31, 2009, we had systems placed under our shared ownership program only in the U.S. We recognize revenue monthly from our shared ownership program that consists of a minimum monthly payment. We also recognize usage-based revenue in excess of the monthly minimum based on usage reports from our customers. We recognized revenue from our shared ownership program of $0.5 million and $0.9 million for the three and six months ended December 31, 2009, respectively. We recognized revenue from our shared ownership program of $0.9 million and $1.9 million for the three and six months ended December 31, 2008, respectively. In limited cases, we received nonrefundable upfront payments from shared ownership program customers which are treated as deferred revenue and recognized over the term of the contract.

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The CyberKnife system shared ownership systems are recorded within property and equipment and are depreciated over their estimated life of seven years. Depreciation and warranty expense attributable to shared ownership systems are recorded within cost of shared ownership program as they are incurred.

International Sales Revenue

We sell our products internationally through a combination of direct sales force and a network of distributors. We have strategically developed distributor relationships to serve our customers. Many of our distributors are responsible for installation and front-end support.

For international sales, we recognize revenue once we have met all of our obligations associated with the purchase agreement, other than for undelivered service elements for which we have VSOE of fair value. In most cases, this occurs after the distributor has shipped the unit to the end user or provided evidence of proof of sell-through to the end user, assuming all of our remaining obligations have been satisfied. Payments are sometimes secured through letters of credit. In situations where we are directly responsible for installation, we recognize revenue once we have installed the CyberKnife system and have confirmed performance against specification. Net revenue from international customers was $12.1 million and $32.0 million for the three and six months ended December 31, 2009, respectively. Net revenue from international customers was $22.1 million and $35.7 million for the three and six months ended December 31, 2008, respectively.

Backlog

To be reported in our backlog, an order must have no contingencies as well as meet certain criteria. Most of the non-contingent contracts that are not included in the reported backlog did not meet the criteria because we had not received a deposit for the orders. Those orders were generally from international distributors as we have not always required a deposit on such orders. At December 31, 2009, our backlog was $325 million. There were no cancellations in the second quarter of fiscal year 2010 of orders previously reported as part of backlog.

Although our backlog includes only contractual commitments from our customers, we can not make assurances that we will convert it into recognized revenue due to factors outside our control, such as changes in customers needs.

Results of Operations