

ACCURAY INC  
Form 10-Q  
January 27, 2011  
Table of Contents

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

**For the quarterly period ended December 31, 2010**

**or**

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

**For the transition period from                      to**

**Commission File Number: 001-33301**

**ACCURAY INCORPORATED**

(Exact Name of Registrant as Specified in Its Charter)

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**Delaware**

(State or Other Jurisdiction of Incorporation or Organization)

**20-8370041**

(IRS Employer Identification Number)

**1310 Chesapeake Terrace**

**Sunnyvale, California 94089**

(Address of Principal Executive Offices Including Zip Code)

**(408) 716-4600**

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of January 12, 2011, there were 61,912,268 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 December 31, 2010**

**Table of Contents**

	<b>Page No.</b>
<b><u>PART I.</u></b> <b><u>Financial Information</u></b>	3
<b><u>Item 1.</u></b> <u>Condensed Consolidated Financial Statements (unaudited):</u>	3
<u>Condensed Consolidated Balance Sheets</u>	3
<u>Condensed Consolidated Statements of Operations</u>	4
<u>Condensed Consolidated Statements of Cash Flows</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
<b><u>Item 2.</u></b> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	19
<b><u>Item 3.</u></b> <u>Quantitative and Qualitative Disclosures About Market Risk</u>	30
<b><u>Item 4.</u></b> <u>Controls and Procedures</u>	30
<b><u>PART II.</u></b> <b><u>Other Information</u></b>	31
<b><u>Item 1.</u></b> <u>Legal Proceedings</u>	31
<b><u>Item 1A.</u></b> <u>Risk Factors</u>	31
<b><u>Item 2.</u></b> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	50
<b><u>Item 3.</u></b> <u>Defaults Upon Senior Securities</u>	51
<b><u>Item 4.</u></b> <u>(Removed and Reserved)</u>	51
<b><u>Item 5.</u></b> <u>Other Information</u>	51
<b><u>Item 6.</u></b> <u>Exhibits</u>	51
<b><u>Signatures</u></b>	52

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

(in thousands, except share and per share amounts)

(unaudited)

	<b>December 31, 2010</b>	<b>June 30, 2010</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 49,513	\$ 45,434
Restricted cash	22	22
Short-term available-for-sale securities	102,427	99,881
Accounts receivable, net of allowance for doubtful accounts of \$251 and \$115 at December 31, 2010 and June 30, 2010, respectively	29,856	37,955
Inventories	35,646	28,186
Prepaid expenses and other current assets	8,608	19,356
Deferred cost of revenue - current	4,892	7,889
Total current assets	230,964	238,723
Deferred cost of revenue - noncurrent	2,385	3,213
Property and equipment, net	16,590	14,684
Goodwill	4,495	4,495
Intangible assets, net	259	388
Other assets	1,727	1,681
Total assets	\$ 256,420	\$ 263,184
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Accounts payable	\$ 8,447	\$ 10,317
Accrued compensation	9,540	10,786
Other accrued liabilities	7,285	10,669
Customer advances	13,784	12,884
Deferred revenue - current	34,838	42,019
Total current liabilities	73,894	86,675
Long-term liabilities:		
Long-term other liabilities	1,030	1,059
Deferred revenue - noncurrent	3,905	5,374
Total liabilities	78,829	93,108
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, \$0.001 par value; authorized: 5,000,000 shares; no shares issued and outstanding		

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Common stock, \$0.001 par value; authorized: 100,000,000 shares; issued: 61,865,443 and 60,666,974 shares at December 31, 2010 and June 30, 2010, respectively; outstanding: 59,725,425 and 58,526,956 shares at December 31, 2010 and June 30, 2010, respectively

Additional paid-in capital	60	59
Additional paid-in capital	295,801	287,764
Accumulated other comprehensive loss	(25)	(71)
Accumulated deficit	(118,245)	(117,676)
Total stockholders' equity	177,591	170,076
Total liabilities and stockholders' equity	\$ 256,420	\$ 263,184

Condensed consolidated balance sheet at June 30, 2010 has been derived from audited consolidated financial statements.

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

Table of Contents**Accuray Incorporated****Condensed Consolidated Statements of Operations**

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
<b>Net revenue:</b>				
Products	\$ 34,391	\$ 35,686	\$ 53,666	\$ 66,032
Shared ownership programs	880	456	1,521	937
Services	18,846	20,688	36,580	40,342
Other	129	491	547	585
Total net revenue	54,246	57,321	92,314	107,896
<b>Cost of revenue:</b>				
Cost of products	13,134	17,556	20,459	32,207
Cost of shared ownership programs	122	329	294	650
Cost of services	11,380	13,133	23,180	27,053
Cost of other	144	339	678	403
Total cost of revenue	24,780	31,357	44,611	60,313
Gross profit	29,466	25,964	47,703	47,583
<b>Operating expenses:</b>				
Selling and marketing	7,987	10,063	15,747	18,712
Research and development	9,313	7,769	17,360	15,431
General and administrative	8,481	10,430	17,040	19,360
Total operating expenses	25,781	28,262	50,147	53,503
Income (loss) from operations	3,685	(2,298)	(2,444)	(5,920)
Other income, net	676	426	2,292	911
Income (loss) before provision for (benefit from) income taxes	4,361	(1,872)	(152)	(5,009)
Provision for (benefit from) income taxes	263	(696)	390	(557)
Net income (loss)	\$ 4,098	\$ (1,176)	\$ (542)	\$ (4,452)
<b>Net income (loss) per share:</b>				
Basic net income (loss) per share	\$ 0.07	\$ (0.02)	\$ (0.01)	\$ (0.08)
Weighted average common shares used in computing basic net income (loss) per share	59,282	57,405	58,975	57,112
Diluted net income (loss) per share	\$ 0.07	\$ (0.02)	\$ (0.01)	\$ (0.08)
Weighted average common shares used in computing diluted net income (loss) per share	61,376	57,405	58,975	57,112

*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)

	<b>Six Months Ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash Flows From Operating Activities</b>		
Net loss	(542)	\$ (4,452)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,890	3,892
Stock-based compensation	4,451	6,354
Realized gain on investments	(3)	(2)
Unrealized loss on long-term trading securities, net of gain on put option		(227)
Provision for bad debts	136	(460)
Loss on write-down of inventories	675	2,162
Loss (gain) on disposal of property and equipment	(117)	18
Restricted cash		(394)
Changes in assets and liabilities:		
Accounts receivable	8,480	(990)
Inventories	(8,783)	1,934
Prepaid expenses and other current assets	796	(3,119)
Deferred cost of revenue	5,315	2,804
Other assets	(15)	(161)
Accounts payable	(4,009)	(3,731)
Accrued liabilities	(802)	3,400
Customer advances	631	525
Deferred revenue	(8,888)	(16,416)
Net cash provided by (used in) operating activities	215	(8,863)
<b>Cash Flows From Investing Activities</b>		
Purchases of property and equipment	(3,250)	(950)
Purchase of investments	(71,619)	(36,651)
Sale and maturity of investments	74,929	47,850
Net cash provided by investing activities	60	10,249
<b>Cash Flows From Financing Activities</b>		
Proceeds from issuance of common stock	2,543	1,066
Proceeds from employee stock purchase plan	973	872
Excess tax benefit from stock-based compensation		(498)
Net cash provided by financing activities	3,516	1,440
Effect of exchange rate changes on cash	288	(198)
Net increase in cash and cash equivalents	4,079	2,628
Cash and cash equivalents at beginning of period	45,434	36,835
Cash and cash equivalents at end of period	\$ 49,513	\$ 39,463

*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) 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. Physicians determine when and how the CyberKnife system should be used in the treatment of patients. The CyberKnife system is designed to treat small to medium sized, discrete tumors, and is generally not used to treat (1) very large tumors, which are considerably wider than the radiation beam that can be delivered by the CyberKnife system, (2) diffuse, wide-spread disease, as is often the case for late stage cancers, because they are not localized (though the CyberKnife system might be used to treat a focal area of the disease) and (3) systemic disease, like leukemias and lymphomas, which are not localized to an organ, but rather involve cells throughout the body.

The Company is incorporated in Delaware, USA and has thirteen 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, Accuray Medical Equipment GmbH, located in Munich, Germany, Accuray Tibbi Cihazlar Ve Malzemeler Ithalat Ihracat Anonim Sirketi, located in Istanbul, Turkey, Accuray Mexico SA de CV located in Mexico City, Mexico and Accuray Medical Equipment Canada Ltd. located in Vancouver, Canada. The purpose of these subsidiaries is to market and/or service the Company's products in the various countries in which they are located.

**2. Summary of Significant Accounting Policies**

**Basis of Presentation and Principles of Consolidation**

The condensed consolidated financial statements for the 2010 fiscal year include the accounts of the Company and its subsidiaries and the Company's variable interest entity, Morphormics, Inc. ( Morphormics ). As the Company is no longer considered the primary beneficiary of Morphormics, the condensed consolidated financial statements for fiscal year 2011 do not include Morphormics. Refer to Note 6. Investment . All significant inter-company transactions and balances have been eliminated in consolidation.

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The accompanying condensed consolidated balance sheet as of December 31, 2010 and the condensed consolidated statements of operations for the three and six-month periods ended December 31, 2010 and 2009 and the condensed consolidated statements of cash flows for the six-month periods ended December 31, 2010 and 2009 and other information disclosed in the related notes are unaudited. The condensed consolidated balance sheet as of June 30, 2010 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, 2010 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 results for the three and six months ended December 31, 2010 are not necessarily indicative of the results to be expected for the year ending June 30, 2011 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.

Table of Contents

**Foreign Currency**

The Company's international subsidiaries use their local currencies as their functional currencies. For those subsidiaries, assets and liabilities are translated at exchange rates in effect at the balance sheet date and income and expense accounts at the average exchange rate. Resulting translation adjustments are excluded from the determination of net income and are recorded in accumulated other comprehensive income (loss) 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 for the three and six months ended December 31, 2010.

The majority of the Company's executed sales contracts are denominated in U.S. dollars. The CyberKnife system sales contracts denominated in foreign currency are direct end customer transactions for international customers.

**Cash and Cash Equivalents**

The Company considers all highly liquid investments with 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 has historically included 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. At December 31, 2010 and 2009, restricted cash balance represents funds held to guarantee funding of certain foreign taxes.

**Fair Value of Financial Instruments**

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

**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,

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with unrealized gains and losses recorded in stockholders' equity and included in accumulated other comprehensive income (loss). 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 maturities greater than approximately three months on the date of purchase and remaining maturities of one year or less are classified as short-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.

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

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

For the three and six months ended December 31, 2010 and 2009, there were no customers that represented 10% or more of total net revenue. The following summarizes the accounts receivable from customers in excess of 10% of total accounts receivable:

	December 31, 2010	June 30, 2010
Customer A	10%	
Customer B	14%	
Customer C	10%	

## Table of Contents

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 use of standard costs.

## **Revenue Recognition**

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

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 revenue arrangements with multiple elements which were entered into by June 30, 2010 and which have not subsequently been materially modified, the Company allocates arrangement consideration to each element based upon vendor specific objective evidence ( VSOE ) of fair value of the respective elements. VSOE of fair value for each element is based upon the Company's standard rates charged for the product or service when such product or service is sold separately or based upon the price established by the Company's pricing committee when that product or service is not yet being sold separately. When contracts contain multiple elements, and VSOE of fair value exists for all undelivered elements, the Company accounts for the delivered elements, principally the 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, and (2) establishment of VSOE of fair value for all remaining undelivered elements.

In the first quarter of fiscal 2011, the Company adopted Accounting Standards Update ( ASU ) 2009-13, *Multiple-Deliverable Revenue Arrangements*, (amendments to Accounting Standards Codification ( ASC ) Topic 605, *Revenue Recognition*) ( ASU 2009-13 ) (formerly Emerging Issues Task Force ( EITF ) Issue 08-1) and ASU 2009-14, *Certain Arrangements That Include Software Elements*, (amendments to Financial Accounting Standards Board ( FASB ) ASC Topic 985, *Software*) ( ASU 2009-14 ) (formerly EITF 09-3). The new standard changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price. The FASB also amended the accounting standards for revenue recognition to exclude software that is contained in a tangible product from the scope of software revenue guidance if the software is essential to

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the tangible product's functionality. The Company adopted these new standards on a prospective basis; therefore, they apply only to revenue arrangements entered into or materially modified beginning July 1, 2010. For revenue arrangements that were entered into or materially modified after the adoption of these standards, implementation of this new authoritative guidance had an insignificant impact on the Company's reported net revenue in the first quarter of fiscal 2011 as compared to net revenue if the related arrangements entered into or modified after the effective date were subject to the accounting requirements in effect in the prior year.

Under the new accounting guidance, in evaluating the revenue recognition for agreements which contain multiple deliverables, the Company determined that in certain instances it was not able to establish VSOE for all deliverables in an arrangement as the Company infrequently sells each element on a stand-alone basis, does not price products within a narrow range, or has a limited sales history. When VSOE cannot be established, the Company attempts to establish the selling price of each element based on relevant third-party evidence ( TPE ). TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, the Company's offerings contain a significant level of proprietary technology, customization or differentiation such that the comparable pricing of products with similar functionality cannot be obtained. Furthermore, the Company is unable to reliably determine what similar competitor products' selling prices are on a stand-alone basis. Therefore, the Company typically is not able to determine TPE.

Table of Contents

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

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

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

The Company 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.

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

*CyberKnife sales with legacy service plans*

For sales of CyberKnife systems with PCS arrangements entered into prior to the first quarter of fiscal 2011 that included rights to specified or committed upgrades for which the Company had not established VSOE of fair value, all revenue and cost of revenue related to the CyberKnife systems and subsequent PCS was deferred. Once all such upgrade obligations had been delivered, all accumulated and deferred revenue and cost of revenue for the CyberKnife systems and related PCS began to be 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 were considered additional elements of the original arrangement and associated revenues were deferred and accounted for as described above. Sales of additional upgrades after delivery of all specified upgrade obligations, as stated in the original contract, were recognized once all revenue recognition criteria applicable to those arrangements were met.

*CyberKnife sales with nonlegacy service plans*

Currently, the Company sells CyberKnife systems with PCS contracts that 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 entered into after June 30, 2010, with multiple elements that include the CyberKnife system, installation services, training services and a PCS service agreement, the Company recognizes revenue for the CyberKnife system and installation services, if applicable, by application of the relative selling price method for all elements in the arrangement, including PCS. If the Company is responsible for installation, the Company recognizes revenue only after installation and acceptance of the system. Otherwise, revenue is recognized upon delivery.

*Other revenue*

Other revenue primarily consists of research and development contract revenues.

*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 obligations 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.



Table of Contents

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

*Distributor sales*

Sales to third party distributors are evidenced by a distribution agreement governing the relationship together with binding purchase orders or signed quotations 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 exists, the fees are fixed or determinable, collection of the resulting receivable is probable and there is no right of return.

*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 and minimum monthly payments from the customer are recognized as revenue over the contractual period. Additional revenues beyond the minimum payments from the shared ownership program are recorded as they become earned and receivable and are included within shared ownership program revenues in the condensed consolidated statements of operations. The Company recognized \$0.88 million and \$1.52 million for the three and six months ended December 31, 2010, respectively, of revenue from the shared ownership program. The Company recognized \$0.46 million and \$0.94 million for the three and six months ended December 31, 2009, respectively, of revenue from the shared ownership program.

Future minimum revenues under shared ownership arrangements as of December 31, 2010 are as follows (in thousands):

2011 (remaining six months)	\$	259
2012		794
2013		734
2014		554
2015		693
Total	\$	3,034

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 \$0.06 million and \$0.12 million for the three and six months ended December 31, 2010, 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 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. Product revenue of \$3.6 million was recognized during the three and six months ended December 31, 2010 from the sale of one CyberKnife system that was formerly a part of the Company's shared ownership program.

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

*Long-term construction and manufacturing contracts*

The Company recognizes revenue and cost of revenue related to long-term construction and manufacturing contracts using contract accounting on the percentage-of-completion or the completed contract method. The Company recognizes any loss provisions from the total contract in the period such loss is identified.

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 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 typically results from the payment for services to be delivered over a contractual service period, usually one year. Service revenue is recognized ratably over the service period. Deferred cost of revenue consists of the direct costs associated with the manufacturing of units or upgrade products, service upgrade costs for which the revenue has been deferred in accordance with the Company's revenue recognition policy, and deferred costs associated with research and development contract costs. 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 Purchased Intangible Assets**

Goodwill and purchased 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 purchased 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, 2010, there were no indicators of impairment.

**Stock-Based Compensation**

The Company accounts for stock-based compensation by measuring and recognizing the fair value of all stock-based payment awards made to employees based on the estimated grant date fair values, including employee stock options, restricted stock awards and the employee stock based purchase plan. The determination of fair value involves a number of significant estimates. The Company uses the Black-Scholes option pricing model to estimate the value of employee stock options which requires a number of assumptions to determine the model inputs. These include the expected volatility of the stock's market price, the expected term of the stock-based awards, the expected risk free rate of interest and any dividend yields. As stock-based compensation expense is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. The Company estimates and adjusts forfeiture rates based on a periodic review of recent forfeiture activity and expected future employee turnover. As the Company has been operating as a public company for a period of time that is shorter than its estimated expected option life, the Company concluded that its historical price volatility does not provide a reasonable basis for input assumptions within its Black-Scholes valuation model when determining the fair value of its stock options. As a result, expected volatility is based on the historical volatility of a peer group of publicly traded companies. The Company continues to use the simplified method for the estimated term of the awards.

**Income and Other Taxes**

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

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

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 Share**

Basic net income (loss) per share is calculated based on the weighted-average number of shares of the Company's common stock outstanding during the period. Common stock equivalent shares, which are based on the number of shares underlying outstanding stock options and RSUs, are included in the calculation of diluted net income per share unless the effect of their inclusion would be anti-dilutive. For the three months ended December 31, 2010 and 2009, 4,147,790 and 6,642,583 of anti-dilutive weighted shares, respectively, were excluded from the calculation of common stock equivalent shares. For the six months ended December 31, 2010 and 2009, 6,135,039 and 6,743,898 of anti-dilutive weighted shares, respectively, were excluded from the calculation of common stock equivalent shares.

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### Table of Contents

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

(In thousands, except per share data)	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
<b>Numerator:</b>				
Net income (loss)	\$ 4,098	\$ (1,176)	\$ (542)	\$ (4,452)
<b>Denominator:</b>				
Basic weighted-average shares outstanding	59,282	57,405	58,975	57,112
Stock options and restricted stock units	2,094			
Diluted weighted-average shares of common stock and equivalent outstanding	61,376	57,405	58,975	57,112
Basic net income (loss) per share:	\$ 0.07	\$ (0.02)	\$ (0.01)	\$ (0.08)
Diluted net income (loss) per share:	\$ 0.07	\$ (0.02)	\$ (0.01)	\$ (0.08)

### **Comprehensive Income (Loss)**

Comprehensive income (loss) is comprised of net income (loss) and other comprehensive loss. Other comprehensive 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, 2010 and 2009 is as follows (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
Net income (loss)	\$ 4,098	\$ (1,176)	\$ (542)	\$ (4,452)
Unrealized gain (loss) on investments	(25)	(124)	2	(147)
Foreign currency translation	(46)	(13)	44	1
Comprehensive income (loss)	\$ 4,027	\$ (1,313)	\$ (496)	\$ (4,598)

### **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.

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,	
	2010	2009	2010	2009
Americas (including Puerto Rico)	\$ 38,890	\$ 45,256	\$ 61,961	\$ 75,882
Europe	10,575	8,460	20,525	25,089
Asia (excluding Japan)	3,689	868	7,021	1,593
Japan	1,092	2,737	2,807	5,332
Total	\$ 54,246	\$ 57,321	\$ 92,314	\$ 107,896

### Recent Accounting Pronouncement

In January 2010, the FASB issued ASU No. 2010-06, *Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06 amends FASB 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. The new disclosures and clarifications under this ASU are effective over a period of two fiscal years, for interim and annual reporting periods beginning after December 15, 2009 and after December 15, 2010. The first adoption date updates under ASU No. 2010-06 did not have a material impact on the Company's consolidated financial statements. The adoption of the second date of updates is not expected to have a material impact on the Company's consolidated financial statements.

Table of Contents

**3. Collaboration Agreement**

In June of 2010, the Company entered into a Strategic Alliance Agreement, or the Alliance Agreement, with Siemens AG, or Siemens, pursuant to which (1) the Company agreed to grant Siemens certain distribution rights to CyberKnife systems, (2) Siemens agreed to incorporate certain technology of the Company into certain of its linear accelerator products, the combined products being known as the Cayman Products, and (3) a research and development relationship was created between the Company and Siemens for the pursuit and implementation of other potential collaboration opportunities in the future.

The Alliance Agreement provides that Accuray will grant Siemens distribution rights to the CyberKnife system, allowing Siemens to include the CyberKnife system in multi-product sales when it also sells its own linear accelerator products or imaging products. The Company and Siemens entered into a Multiple Linac and Multi-Modality Distribution Agreement, or Distribution Agreement, which sets forth the terms of these distribution rights. Each sale under the Distribution Agreement is subject to pre-approval by the Company. The Alliance Agreement also provides that Siemens and the Company will negotiate in good faith separate distribution agreements for the distribution by Siemens of the CyberKnife system in certain countries and regions throughout the world not currently able to be fully served by the Company.

The Alliance Agreement also provides that Siemens will pay the Company a fee to develop certain technology. Siemens will have the exclusive right to purchase from the Company products incorporating this technology solely for use in Cayman Products, but the Company may terminate Siemens' exclusivity if Siemens fails to meet certain specified sales targets, or if the initial shipment of a Cayman Product does not occur within a specified period of time. The Alliance Agreement further provides that Siemens and the Company plan to develop a product concept for future joint technology development and cooperate in good faith to explore additional opportunities for ongoing collaboration on complementary technology developments.

The Alliance Agreement has a five year initial term, which will automatically renew for successive one year terms unless a party gives notice of termination to the other party at least six months before the end of a term.

As of December 31, 2010 Siemens and the Company had not yet agreed on the definition of a specification for the first Cayman Product as originally anticipated, therefore little development work and no milestone payments have occurred. Recently Siemens has reorganized its Healthcare division and the Company is in discussion with the new management within Siemens Healthcare regarding this project.

**4. 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 had entered into an agreement ( Rights Agreement ) with UBS, which provided the Company with ARS ( Auction Rate Security ) Rights ( Rights ) to sell its ARS at par value to UBS at any time during the period June 30, 2010 through July 2, 2012.

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.

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, 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, 2009, UBS redeemed \$0.1 million and \$0.2 million, respectively, of the ARS, which generated realized gains that were not material. No activity related to the fair value of the put option is included in the Company's condensed consolidated statement of operations for the three and six months ended December 31, 2010 due to the liquidation of the underlying ARS securities as of June 30, 2010.



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### Table of Contents

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 in which management's estimate utilizes market participant assumptions.

The following tables sets forth by level within the fair value hierarchy the Company's financial instruments that were accounted for at fair value on a recurring basis at December 31, 2010 and June 30, 2010, according to the valuation techniques the Company used to determine their fair values (in thousands):

	Fair Value at December 31, 2010		Fair Value Measurements Using Inputs Considered as			
			Level 1	Level 2		
Money market funds	\$	3,805	\$	3,805	\$	
Corporate notes		30,426				30,426
Commercial paper		48,163				48,163
U.S. government agency securities		24,837				24,837
<b>Total</b>	\$	<b>107,231</b>	\$	<b>3,805</b>	\$	<b>103,426</b>

	Fair Value at June 30, 2010		Fair Value Measurements Using Inputs Considered as			
			Level 1	Level 2		
Money market funds	\$	1,104	\$	1,104	\$	
Corporate notes		34,992				34,992
Commercial paper		22,513				22,513
U.S. government agency securities		43,774				43,774

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Total	\$	102,383	\$	1,104	\$	101,279
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As of December 31, 2010 and June 30, 2010, the Company had no assets or liabilities using Level 3 inputs.

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### Table of Contents

Investments in marketable securities classified as available-for-sale by security type at December 31, 2010 and June 30, 2010, consisted of the following (in thousands):

	December 31, 2010				Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		
<b>Short-term investments:</b>					
Commercial paper	\$ 47,158	\$ 11	\$ (5)		\$ 47,164
Corporate notes	30,412	18	(4)		30,426
U.S. government agency securities	24,816	21			24,837
<b>Total short-term investments</b>	<b>\$ 102,386</b>	<b>\$ 50</b>	<b>\$ (9)</b>		<b>\$ 102,427</b>

	June 30, 2010				Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		
<b>Short-term investments:</b>					
Commercial paper	\$ 21,126	\$ 64	\$ (11)		\$ 21,115
Corporate notes	34,957	64	(29)		34,992
U.S. government agency securities	43,761	15	(2)		43,774
<b>Total short-term investments</b>	<b>\$ 99,844</b>	<b>\$ 79</b>	<b>\$ (42)</b>		<b>\$ 99,881</b>

As of December 31, 2010 and June 30, 2010, the Company had no long-term investments in marketable securities classified as available-for-sale.

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, 2010. The Company has determined that the gross unrealized losses on its marketable securities at December 31, 2010 were temporary in nature.

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 open-ended mutual funds that typically invest in short-term debt securities. Money market funds are classified as cash and cash equivalents on the Company's condensed consolidated balance sheets. The Company classified these funds that are specifically backed by debt securities as Level 1 instruments due to its usage of unadjusted quoted prices that are available in active markets for the identical assets or liabilities at the measurement date.

*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 total fair value of commercial paper held as of December 31, 2010 of \$48.2 million includes \$1.0 million of money market funds invested in commercial paper which is classified as cash equivalents. The total fair value of commercial paper held as of June 30, 2010 of \$22.5 million includes \$1.4 million of money market funds invested in commercial paper which is classified as cash equivalents. The portion in cash and cash equivalents represents highly liquid debt instruments with insignificant interest rate risk and maturities of ninety days or less at the time of purchase. 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 agency securities.* U.S. government agency securities are issued by U.S. Federal, state and local governments, government-sponsored enterprises, and governmental entities such as authorities or special districts that generally mature within two 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 agency securities. 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.

Table of Contents**5. Balance Sheet Components****Accounts receivable, net**

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

	December 31, 2010		June 30, 2010
Accounts receivable	\$ 29,901	\$	37,861
Unbilled fees and services	206		209
	30,107		38,070
Less: Allowance for doubtful accounts	(251)		(115)
Accounts receivable, net	\$ 29,856	\$	37,955

**Inventories**

Inventories consist of the following (in thousands):

	December 31, 2010		June 30, 2010
Raw materials	\$ 15,276	\$	13,683
Work-in-process	9,021		5,987
Finished goods	11,349		8,516
Total inventories	\$ 35,646	\$	28,186

**Property and Equipment, net**

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

	December 31, 2010		June 30, 2010
Furniture and fixtures	\$ 3,722	\$	3,628
Computer and office equipment	8,884		8,297
Leasehold improvements	8,010		7,771
Machinery and equipment	16,576		15,291
CyberKnife shared ownership systems	3,701		5,216
Construction In Progress	4,550		1,927

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	45,443	42,130
Less: Accumulated depreciation and amortization	(28,853)	(27,446)
Property and equipment, net	\$ 16,590	\$ 14,684

Depreciation and amortization expense related to property and equipment for the three and six months ended December 31, 2010 was \$1.4 million and \$2.7 million, respectively. 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. Accumulated depreciation related to the CyberKnife systems attributable to the shared ownership program as of December 31, 2010 and June 30, 2010 was \$1.9 million and \$1.8 million, respectively.

Of the \$4.6 million recorded in construction in process, \$3.8 million relates to the Company's implementation of a new enterprise resource planning information system, and includes capitalized costs relating to license and consulting fees. The new enterprise resource planning information system commenced live operations in January 2011.

### 6. 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 was considered to be at risk and was deemed not sufficient to finance Morphormics' current product development activities without additional subordinated financial support. In addition, the Company was deemed to be Morphormics' primary beneficiary, therefore, it would absorb a majority of expected losses. The Company consolidated Morphormics in its financial results. The consolidation of Morphormics' assets and liabilities did not have a material effect on the Company's consolidated balance sheet at June 30, 2010. The Company recorded losses for the three and six months ended December 31, 2009 of \$0.2 million and \$0.4 million, respectively. As of June 30, 2010, the investment amount had been substantially utilized by Morphormics.

Table of Contents

Effective July 1, 2010, the determination of primary beneficiary status has changed from a quantitative approach to a qualitative approach under which the Company is no longer considered the primary beneficiary of Morphormics. The Company has deconsolidated Morphormics' assets and liabilities from its consolidated balance sheet as of July 1, 2010. The deconsolidation of the Company's investment in Morphormics, resulting in a net cumulative-effect adjustment to accumulated deficit of \$27,000 on the Company's condensed consolidated balance sheet.

As of July 1, 2010, the Company determined the fair value of the investment using an income approach. The assumptions for the valuation included historical financial data, operating projections, estimated future cash flows and an adjustment for lack of liquidity.

**7. 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 were consolidated. The consolidated complaint generally alleges 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. On August 31, 2010, the Court granted defendants' motion to dismiss the consolidated complaint and granted plaintiffs leave to file an amended complaint. On September 27, 2010, plaintiffs filed an amended complaint. The amended complaint names the Company and certain of its current and former officers and directors as defendants and generally alleges that the defendants made false or misleading public statements regarding the Company's operations. The amended complaint seeks unspecified monetary damages and other relief. Defendants have filed a motion to dismiss the amended complaint.

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 February 25, 2010, the plaintiff dismissed the action without prejudice.

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. Three other shareholder derivative lawsuits were filed in the same court on November 30, 2009, December 1, 2009 and March 16, 2010. These actions have been consolidated. The amended 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 federal and California securities laws. The amended consolidated complaint seeks unspecified monetary damages and other relief. On August 31, 2010, the Court granted defendants' motion to dismiss, with leave to amend. On September 27, 2010, plaintiffs filed a notice of their intent not to file an amended complaint. On October 6, 2010, judgment was entered and the action dismissed. Plaintiffs filed a notice of appeal to the U.S. Court of Appeals for the Ninth Circuit on November 5, 2010.

On September 3, 2009, Best Medical International, Inc. ( "Best Medical" ) filed a lawsuit against the Company in the U.S. District Court for the Western District of Pennsylvania, claiming the Company induced certain individuals to leave the employment of Best Medical and join the

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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 August 6, 2010, Best Medical filed an additional lawsuit against the Company in the U.S. District Court for the Western District of Pennsylvania, claiming the Company has infringed U.S. Patent No. 5,596,619, a patent that Best Medical alleges protects a method and apparatus for conformal radiation therapy. On December 2, 2010, the Court granted the Company's motion to dismiss, with leave to amend. On December 16, 2010 Best Medical filed an amended complaint, claiming that the Company also infringes U.S. Patent Nos. 6,038,283 and 7,266,175, both of which Best Medical alleges cover methods and apparatus for conformal radiation therapy. Best Medical is seeking declaratory and injunctive relief as well as unspecified compensatory and treble damages and other relief. At this time, the Company does not have enough information to estimate what, if any, financial impact this claim will have.

As of December 31, 2010, the Company has not recorded any liabilities for the above referenced lawsuits as we are unable to determine if a loss is 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



Table of Contents

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, 2010.

**8. 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,	
	2010	2009	2010	2009
Cost of revenue	\$ 181	\$ 445	\$ 644	\$ 676
Selling and marketing	113	655	357	1,463
Research and development	620	653	1,294	1,301
General and administrative	1,041	1,496	2,156	2,914
	\$ 1,955	\$ 3,249	\$ 4,451	\$ 6,354

At December 31, 2010 and June 30, 2010, capitalized stock-based compensation costs of \$0.3 million and \$0.2 million, respectively, were included as components of inventories.

**9. Goodwill and Other Purchased Intangibles**

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. 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 performed the annual test for impairment of goodwill in December 2010 concluding that there was no impairment of goodwill. The amortization expense related to intangible assets for the three months ended December 31, 2010 and 2009 was \$0.1 million and \$0.1 million, respectively. The following table represents the gross carrying amounts and accumulated amortization of amortized intangible assets at December 31, 2010 and June 30, 2010 (in thousands):

	December 31, 2010	June 30, 2010
Complete technology	\$ 1,740	\$ 1,740
Customer contract / relationship	70	70
	1,810	1,810
Less: Accumulated amortization	(1,551)	(1,422)
Intangible assets, net	\$ 259	\$ 388

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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 December 31, 2010, is as follows (in thousands):

Year ending June 30,		
2011 (remaining six months)	\$	130
2012		129
Total	\$	259

Table of Contents

**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, 2010 and results of operations for the three and six months ended December 31, 2010 and 2009 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, including statements regarding the extent and timing of future revenues and expenses, statements regarding reimbursement rates, statements regarding regulatory requirements, statements regarding future orders, statements regarding our strategic alliance with Siemens AG, statements regarding the manufacture and deployment of our products, statements regarding market position, sales cycle, revenues, earnings or other financial results, and other statements using words such as anticipates, believes, could, estimates, expects, forecasts, intends, may, plans, projects, should, will and would, and words of similar import and the negatives thereof. Our actual results, performance or achievements could differ materially from those expressed or implied by the forward-looking statements on the basis of several factors, including those that we discuss in Risk Factors, set forth in Part II, Item 1A of this quarterly report on Form 10-Q. We encourage you to read that section carefully. 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.*

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

**Overview**

We have developed what we believe to be 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. Physicians determine when and how the CyberKnife system should be used in the treatment of patients. The CyberKnife system is designed to treat small to medium sized, discrete tumors, and is generally not used to treat (1) very large tumors, which are considerably wider than the radiation beam that can be delivered by the CyberKnife system, (2) diffuse, wide-spread disease, as is often the case for late stage cancers, because they are not localized (though the CyberKnife system might be used to treat a focal area of the disease) and (3) systemic disease, like leukemias and lymphomas, which are not localized to an organ, but rather involve cells throughout the body.

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, or 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.

By way of an overview, in order to operate our business, we are required to first obtain regulatory clearances from governmental agencies in the United States and abroad to market our CyberKnife system, establish an effective and secure supply chain of materials and systems that we then

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manufacture and assemble to create the CyberKnife system, establish direct and distributor sales channels for the sales of our products, provide for ongoing sales and service supports for our products in the field and manage the attendant risks associated with our operations, including risks beyond our control, such as changes in healthcare legislation and Medicare reimbursement rates, which necessarily affect the decisions of physicians and hospitals regarding the purchase of our products.

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. CE mark is an international symbol that represents adherence to certain essential principles of safety and effectiveness mandated in the European Medical Device Directive. 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 110,000 patient treatments.

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

Table of Contents

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 would, however, likely suffer some delays in qualifying any new supplier. 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.

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, 2010, we had 41 employees in our sales organization.

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.

Our CyberKnife systems are either sold to our customers or placed with our customers pursuant to our shared ownership program. As of December 31, 2010, we had 222 CyberKnife systems installed at customer sites, including 219 sold and three pursuant to our shared ownership program. Of the 222 systems installed, 139 are in the Americas, 48 are in Asia and 35 are in Europe.

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 warranty up to two years. 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 program is our Diamond program, which consists of both our Diamond Elite multiyear service plan, or Original Diamond Plan, and our new Diamond Plus multiyear service plan, or Diamond Plus Plan. We introduced our Diamond Plus Plan in the United States during the quarter ended September 30, 2010, and since its implementation, new U.S. customers may purchase the Diamond Plus Plan. Under our original Diamond Plan, customers are eligible to receive up to two upgrades (software or hardware only) per year, when and if available, and under our Diamond Plus Plan, customers are eligible to receive up to twenty upgrades (hardware or software) per year, when and if available, or support services, or a combination of upgrades and support services. Each upgrade available under the Diamond Plus Plan has a value equal to one-tenth the value of the upgrades available under the Original Diamond Plan. Prior to introducing our original 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, 2010 and 2009, 175 out of 180 and 133 out of 148, respectively, of our customers with service plans had purchased non-Platinum service plans.

The CyberKnife procedure is currently covered and reimbursed by Medicare and other governmental and non-governmental third-party payors. Coverage and payment currently exist in the hospital outpatient setting and in the freestanding clinic setting. For calendar year 2011, the national unadjusted average Medicare payment rates under Healthcare Common Procedure Coding System, or HCPCS, are \$3,409 under code G0339, the billing code for the first treatment, and \$2,505 under code G0340, the billing code for each of the second through fifth treatments. The final rates in the hospital outpatient setting reflect a 4.6% decrease for G0339 (\$3,409) and a 0.7% increase for G0340 (\$2,505) compared to 2010. Payment for the freestanding clinic setting is governed by the final Medicare Physician Fee Schedule. For 2011, payment for CyberKnife

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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 freestanding clinic setting. Payment to physicians is based on the Medicare Physician Fee Schedule, and payment amounts are updated on an annual basis. For 2011, Medicare increased 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 ranging from 17% to 23% compared to 2010. 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 stereotactic radiosurgery treatment decreased by two percent.

Our CyberKnife VSI system, introduced in November 2009, allows physicians to perform conventionally fractionated robotic image guided intensity-modulated radiation therapy, or Robotic IMRT, in addition to Robotic Stereotactic Radiosurgery procedures. Medicare 2011 final physician fee schedule rules reflect a two percent increase over 2010 for the treatment delivery code used to report IMRT services delivered by the CyberKnife VSI system.

Table of Contents

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 generally 1 to 2 years before we are able to generate 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.

**Financial Condition**

*Sales and Installation Cycle*

The CyberKnife system has a long sales and installation cycle because it is a major capital purchase for our typical customer and requires the approval of senior management at purchasing institutions. The sales and installation cycle is typically 1 to 2 years in duration and involves multiple steps. The cycle typically begins with customer meetings with sales and products specialists, and ends upon resolution of all contingencies and either upon shipment, if a customer is responsible for installation, or upon installation by us. 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 and can add time to the cycle. 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 stringent 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 generally receive a deposit at the time the purchase agreement is entered into, or shortly thereafter, an additional payment prior to shipment and the remaining balance for the sale of the CyberKnife system after delivery and installation. The customer also typically selects a service plan at the time of signing a CyberKnife system purchase 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 relative selling price of at least one year of service, training and other professional services, if applicable. We recognize the relative selling price of the first year of service as revenue pro rata over the twelve months following installation, training and other professional services, as delivered. In addition, if the customer has purchased either of our Diamond service plans or our Emerald service 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 original Diamond Plan, we offered a Platinum Elite multiyear service plan, or Platinum plan. This legacy service plan was structured so that we had 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 would be 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, when available, 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, or GAAP requires that we cannot

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begin to recognize any of the revenue or cost of sales derived from the sale of the CyberKnife system sold with our Platinum plan 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 that specific CyberKnife system and the Platinum plan over the remaining life of the contract. As of the end of June 2010, we had installed the final upgrades on all systems sold under Platinum agreements. We anticipate that we will satisfy our final obligations under the remaining Platinum service plans mainly during fiscal 2011, with an immaterial amount to complete in fiscal 2012.

### *Warranty*

All customers purchasing a CyberKnife system receive up to a two year warranty. We recognize the CyberKnife system purchase price, minus the relative selling price of support services, upon installation if we are responsible for providing installation or otherwise on shipment. We recognize the relative selling price of the support services ratably over the corresponding period following installation.



Table of Contents

***Shared Ownership Program Revenue***

We recognize revenue, consisting of a minimum monthly payment, monthly from our shared ownership program. 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 \$0.9 million and \$1.5 million for the three and six months ended December 31, 2010,

respectively. 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. 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.

The CyberKnife system shared ownership systems are recorded within property and equipment and are depreciated over their estimated life of seven years. Depreciation and service 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 service support.

For international sales, we recognize revenue once we have met all of our obligations associated with the purchase agreement, other than for undelivered elements at their relative selling price. 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. For sales through distributors, we recognize revenue upon shipment provided that we have received proof of sell-through to the end user from the distributor and that all of our remaining obligations have been satisfied. Net revenue from international customers was \$15.4 million and \$30.4 million for the three and six months ended December 31, 2010, respectively. Net revenue from international customers was \$12.1 million and \$32.0 million for the three and six months ended December 31, 2009, respectively. The increase in international revenue for the three months ended December 31, 2010 was a result principally from the increase in orders in the Europe and Asia regions. We believe the decrease in international sales for the six months ended December 31, 2010 was a result of the varying project and installation schedules by customers in our international markets.

***Backlog***

Backlog consists of the sum of deferred revenue, future un-invoiced payments that our customers are contractually committed to make, signed, non-contingent CyberKnife system sale agreements that meet the detailed criteria set forth below, service plans and minimum payment requirements associated with our shared ownership program. In order for a CyberKnife system sale agreement to be counted as backlog under the refined definition, it must meet the following criteria:

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- The contract is signed and properly executed by both the customer and us;
- The contract is non-contingent it either has cleared all its contingencies or contains no contingencies when signed;
- We have received a deposit or a letter of credit, or the sale is a direct channel sale to a government entity;
- The specific end customer site has been identified by the customer in the written contract or written amendment; and
- Less than 2.5 years have passed since the contract met all the criteria above.

Included in customers' agreements to purchase a CyberKnife system is an option to select the type and term of service coverage that they desire. Backlog includes the value of this service coverage selected by customers in their original agreement to purchase a CyberKnife system. Before installation of the CyberKnife system is complete and service commences, the customer must complete and sign a separate service agreement for service coverage (i.e. Diamond or Emerald service). If at the time of signing the service agreement a customer selects a different type of service than the option selected in the CyberKnife system purchase agreement, our backlog is adjusted to reflect the service agreement the customer signed.

At December 31, 2010 and 2009, our backlog was approximately \$410.2 million and \$325.3 million, respectively. Of total backlog, \$160.50 million and \$115.8 million represented CyberKnife system sales at December 31, 2010 and 2009, respectively, and \$249.7 million and \$209.5 million represented revenue from service plans and other recurring revenues at December 31, 2010 and 2009, respectively. We anticipate that this backlog will be recognized over the next five years as installations occur, upgrades are delivered and services are provided.

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

Table of Contents

**Results of Operations**

*Overview*

Our results of operations are divided into the following components:

**Net revenue.** Our net revenue consists primarily of product revenue (revenue derived primarily from the sale of CyberKnife systems), shared ownership program revenue (revenue generated from our shared ownership program), services revenue (revenue generated from sales of post contract support service plans, installation and training) and other revenue (revenue from specialized services and other non-medical products).

**Deferred Revenue Platinum Multiyear Service Plans.** We are required to defer all of the revenue associated with our Platinum plan, until we have satisfied all of the specified obligations related to the delivery of upgrades to the CyberKnife system during the life of the service plan. This includes deferring revenue for the cash received for the purchase of the CyberKnife system and Platinum service plans until we have delivered all upgrades which the customer is eligible to receive. Once we have satisfied our obligations for delivery of upgrades under the plan, we recognize revenue ratably over the remaining life of the service contract term. We have not offered the Platinum service plan to new customers since we phased it out when we introduced our Diamond plan in November 2005. As of the end of June 2010, we had installed the final upgrades on all systems sold under Platinum agreements.

**Cost of revenue.** Cost of revenue consists primarily of material, labor and overhead costs. Cost of revenue may fluctuate from quarter to quarter depending on system configurations ordered by our customers and overall revenue mix.

**Selling and marketing expenses.** Selling and marketing expenses consist primarily of costs for personnel and costs associated with participation in medical conferences, physician symposia, and advertising and promotional activities. We expect marketing expenses may fluctuate from quarter to quarter due to the timing of major marketing events, such as significant trade shows.

**Research and development expenses.** Research and development expenses consist primarily of activities associated with our product development, regulatory and clinical study arrangements.

**General and administrative expenses.** General and administrative expenses consist primarily of compensation and related costs for finance, in-house legal and human resources, and external expenses related to accounting, legal and other consulting fees.

**Other income, net.** Other income, net consists primarily of interest earned on our cash and cash equivalents and investments, unrealized losses on our long-term trading securities, net of unrealized gains on our put option, foreign currency transaction gains and losses, gains and losses on fixed asset disposals, and state and local sales and use tax fines and penalties.

*Three and Six Months Ended December 31, 2010 Compared to Three and Six Months Ended December 31, 2009***Net Revenue**

(Dollars in thousands)	Three Months Ended December 31,		Variance in Dollars	Variance in Percent	Six Months Ended December 31,		Variance in Dollars	Variance in Percent
	2010	2009			2010	2009		
Products	\$ 34,391	\$ 35,686	\$ (1,295)	(4)%	\$ 53,666	\$ 66,032	\$ (12,366)	(19)%
Shared ownership program	880	456	424	93%	1,521	937	584	62%
Services	18,846	20,688	(1,842)	(9)%	36,580	40,342	(3,762)	(9)%
Other	129	491	(362)	(74)%	547	585	(38)	(6)%
Net Revenue	\$ 54,246	\$ 57,321	\$ (3,075)	(5)%	\$ 92,314	\$ 107,896	\$ (15,582)	(14)%

Total net revenue for the three months ended December 31, 2010 decreased \$3.1 million from the three months ended December 31, 2009. Excluding revenue recognized for systems sold under our Platinum plan, we recognized \$33.9 million and \$32.3 million of product revenue for the three months ended December 31, 2010 and 2009, respectively. Excluding revenue under Platinum service agreements, service revenue totaled \$17.8 million for the three months ended December 31, 2010, up \$2.9 million from the three months ended December 31, 2009 as a result of continued growth in our installed base covered by service plans. As of December 31, 2010 and 2009, 175 out of 180 and 133 out of 148 of our customers that had purchased service plans, respectively, had purchased non-Platinum service plans.

We recognized \$1.5 million of revenue for the three months ended December 31, 2010 from systems sold under our Platinum plan, consisting of \$0.5 million for product revenue and \$1.1 million for service revenue. All Platinum revenue for this period, except \$0.7 million of service revenue, was deferred from prior periods. By comparison, we recognized \$9.2 million of revenue for the three months ended December 31, 2009 from systems sold under our Platinum plan, including \$3.4 million for product revenue and \$5.8 million for service revenue. All Platinum revenue for the three months ended December 31, 2009, except \$1.9 million of service revenue, was deferred from prior periods. As of June 30, 2010, we had satisfied all upgrade delivery obligations on all units sold under our Platinum plan. Once all upgrade delivery obligations have been satisfied, revenue is recognized over the remaining term of the contract service term.

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### Table of Contents

Total net revenue for the six months ended December 31, 2010 decreased \$15.6 million from the six months ended December 31, 2009. Excluding revenue recognized for systems sold under our Platinum plan, we recognized \$52.0 million and \$57.2 million of product revenue for the six months ended December 31, 2010 and 2009, respectively. Excluding revenue under Platinum service agreements, service revenue totaled \$34.0 million for the six months ended December 31, 2010, up \$4.2 million from the six months ended December 31, 2009 as a result of continued growth in our installed base covered by service plans.

We recognized \$4.2 million of revenue for the six months ended December 31, 2010 from systems sold under our Platinum plan, consisting of \$1.6 million for product revenue and \$2.6 million for service revenue. All Platinum revenue for this period, except \$1.4 million of service revenue, was deferred from prior periods. By comparison, we recognized \$19.4 million of revenue for the six months ended December 31, 2009 from systems sold under our Platinum plan, including \$8.8 million for product revenue and \$10.6 million for service revenue. All Platinum revenue for this period, except \$3.7 million of service revenue, was deferred from prior periods.

We anticipate our non-Platinum revenue to continue to grow in future periods, while we expect Platinum revenue to decrease in future periods as these legacy arrangements lapse. Additionally, we expect our service revenue to increase as our installed base continues to grow.

### Gross Profit

	Three Months Ended December 31, 2010				Six Months Ended December 31, 2010				Six Months Ended December 31, 2009			
	(Dollars in thousands)	(% of net revenue)	(Dollars in thousands)	(% of net revenue)	(Dollars in thousands)	(% of net revenue)	(Dollars in thousands)	(% of net revenue)	(Dollars in thousands)	(% of net revenue)	(Dollars in thousands)	(% of net revenue)
Gross profit	\$ 29,466	54.3%	\$ 25,964	45.3%	\$ 47,703	51.7%	\$ 47,583	44.1%	\$ 47,583	44.1%	\$ 47,583	44.1%
Products	\$ 21,257	61.8%	\$ 18,130	50.8%	\$ 33,207	61.9%	\$ 33,825	51.2%	\$ 33,825	51.2%	\$ 33,825	51.2%
Shared ownership program	\$ 758	86.1%	\$ 127	27.9%	\$ 1,227	80.7%	\$ 287	30.6%	\$ 287	30.6%	\$ 287	30.6%
Services	\$ 7,466	39.6%	\$ 7,555	36.5%	\$ 13,400	36.6%	\$ 13,289	32.9%	\$ 13,289	32.9%	\$ 13,289	32.9%
Other	\$ (15)	-11.6%	\$ 152	31.0%	\$ (131)	-23.9%	\$ 182	31.1%	\$ 182	31.1%	\$ 182	31.1%

The increase in gross margin as a percentage of net revenue was primarily due to the improved gross margin of product revenue in the three and six months ended December 31, 2010 compared to the three and six months ended December 31, 2009, as a result of an increase in average selling price and decreases in manufacturing costs. Additionally, service gross margins have increased due to the increase in service revenue, especially in our international regions, as a result of the growth in our installed base coupled with consistent levels of service labor costs and a reduction in service parts costs.

### Selling and Marketing

(Dollars in thousands)	Three Months Ended December 31,		Variance in Dollars	Variance in Percent	Six Months Ended December 31,		Variance in Dollars	Variance in Percent
	2010	2009			2010	2009		
Sales and marketing	\$ 7,987	\$ 10,063	\$ (2,076)	(21)%	\$ 15,747	\$ 18,712	\$ (2,965)	(16)%

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<i>Percentage of net revenue</i>	14.7%	17.6%	17.1%	17.3%
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Selling and marketing expenses for the three months ended December 31, 2010 decreased \$2.1 million compared to the three months ended December 31, 2009. The decrease was primarily attributable to reduced stock-based compensation expense of \$0.5 million and a \$0.6 million decrease in compensation and benefits related expenses as we reduced headcount throughout the last twelve months, a decrease in sales commission of \$0.6 million, and a reduction in consulting service of \$0.3 million representing decreases in outside services for tradeshow and advertising.

Selling and marketing expenses for the six months ended December 31, 2010 decreased \$3.0 million compared to the six months ended December 31, 2009. The decrease was primarily attributable to reduced stock-based compensation expense of \$1.1 million and a \$0.8 million decrease in compensation and benefits related expenses as we reduced headcount throughout the last twelve months, a decrease in sales commission of \$0.6 million, and a reduction in consulting service of \$0.3 million representing decreases in outside services for tradeshow and advertising.

We expect marketing expenses may fluctuate from quarter to quarter due to the timing of major marketing events, such as significant trade shows.

Table of Contents

**Research and Development**

(Dollars in thousands)	Three Months Ended		Variance in	Variance in	Six Months Ended		Variance in	Variance in
	December 31,	December 31,			Dollars	Percent		
	2010	2009			2010	2009		