

VARIAN MEDICAL SYSTEMS INC  
Form 10-Q  
August 07, 2018

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 June 29, 2018

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 1-7598

VARIAN MEDICAL SYSTEMS, INC.  
(Exact name of registrant as specified in its charter)

Delaware 94-2359345  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification Number)

3100 Hansen Way, 94304-1038  
Palo Alto, California (Address of principal executive offices) (Zip Code)  
(650) 493-4000  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  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 (§232.405 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated filer  Accelerated filer   
Non-Accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 91,547,472 shares of common stock, par value \$1 per share, outstanding as of July 27, 2018.

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VARIAN MEDICAL SYSTEMS, INC.  
 FORM 10-Q for the Quarter Ended June 29, 2018  
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PART I  
FINANCIAL INFORMATION

Item 1. Unaudited Financial Statements

VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS  
(Unaudited)

	Three Months Ended		Nine Months Ended	
	June 29, 2018	June 30, 2017	June 29, 2018	June 30, 2017
(In millions, except per share amounts)				
Revenues:				
Product	\$365.0	\$320.2	\$1,124.4	\$994.3
Service	344.1	312.6	993.1	903.2
Total revenues	709.1	632.8	2,117.5	1,897.5
Cost of revenues:				
Product	242.5	225.6	730.6	678.7
Service	153.0	141.7	452.0	410.7
Total cost of revenues	395.5	367.3	1,182.6	1,089.4
Gross margin	313.6	265.5	934.9	808.1
Operating expenses:				
Research and development	59.5	55.1	174.3	158.3
Selling, general and administrative	138.9	121.4	397.4	414.1
Impairment charges	11.0	—	22.1	38.3
Acquisition-related expenses	12.7	0.5	33.9	1.4
Total operating expenses	222.1	177.0	627.7	612.1
Operating earnings	91.5	88.5	307.2	196.0
Interest income	1.8	2.9	8.6	10.4
Interest expense	(1.3 )	(2.7 )	(5.7 )	(8.0 )
Earnings from continuing operations before taxes	92.0	88.7	310.1	198.4
Taxes on earnings	19.5	18.8	276.6	51.0
Net earnings from continuing operations	72.5	69.9	33.5	147.4
Net loss from discontinued operations	—	—	—	(6.8 )
Net earnings	72.5	69.9	33.5	140.6
Less: Net (loss) earnings attributable to noncontrolling interests	(0.1 )	0.2	—	0.7
Net earnings attributable to Varian	\$72.6	\$69.7	\$33.5	\$139.9
Net earnings (loss) per share - basic				
Continuing operations	\$0.79	\$0.76	\$0.37	\$1.58
Discontinued operations	—	—	—	(0.08 )
Net earnings per share - basic	\$0.79	\$0.76	\$0.37	\$1.50
Net earnings (loss) per share - diluted				
Continuing operations	\$0.79	\$0.75	\$0.36	\$1.57
Discontinued operations	—	—	—	(0.07 )
Net earnings per share - diluted	\$0.79	\$0.75	\$0.36	\$1.50

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Shares used in the calculation of net earnings per share:

Weighted average shares outstanding - basic	91.5	91.7	91.6	92.7
Weighted average shares outstanding - diluted	92.5	92.4	92.6	93.5

See accompanying notes to the condensed consolidated financial statements.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS  
 (Unaudited)

	Three Months Ended		Nine Months Ended	
(In millions)	June 29, 2018	June 30, 2017	June 29, 2018	June 30, 2017
Net earnings	\$72.5	\$ 69.9	\$33.5	\$ 140.6
Other comprehensive earnings (loss), net of tax:				
Defined benefit pension and post-retirement benefit plans:				
Amortization of prior service cost included in net periodic benefit cost, net of tax benefit of \$0.1 and \$0.2 for the three and nine months ended June 29, 2018, respectively, and \$0.0* and \$0.1 for the corresponding periods of fiscal year 2017, respectively.	(0.1 )	(0.2 )	(0.6 )	(0.4 )
Amortization of net actuarial loss included in net periodic benefit cost, net of tax expense of (\$0.1) and (\$0.4) for three and nine months ended June 29, 2018, respectively, and (\$0.2) and (\$0.6) for the corresponding periods of fiscal year 2017, respectively.	0.5	0.9	1.7	2.7
	0.4	0.7	1.1	2.3
Derivative instruments:				
Change in unrealized loss, net of tax benefit of \$0.3 for the nine months ended June 29, 2018.	—	—	(0.6 )	—
Reclassification adjustments, net of tax expense of (\$0.3) for the nine months ended June 29, 2018.	—	—	0.6	—
	—	—	—	—
Currency translation adjustment	(12.7 )	14.7	(3.0 )	4.5
Other comprehensive (loss) earnings	(12.3 )	15.4	(1.9 )	6.8
Comprehensive earnings	60.2	85.3	31.6	147.4
Less: Comprehensive (loss) earnings attributable to noncontrolling interests	(0.1 )	0.2	—	0.7
Comprehensive earnings attributable to Varian	\$60.3	\$ 85.1	\$31.6	\$ 146.7

\* Tax expense or benefit related to the periods presented are not material.

See accompanying notes to the condensed consolidated financial statements.

VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (Unaudited)

(In millions, except par values)	June 29, 2018	September 29, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 536.0	\$ 716.2
Trade and unbilled receivables, net of allowance for doubtful accounts of \$40.3 at June 29, 2018 and \$45.9 at September 29, 2017	933.6	961.5
Inventories	469.2	417.7
Prepaid expenses and other current assets	249.8	190.3
Current assets of discontinued operations	4.4	11.1
Total current assets	2,193.0	2,296.8
Property, plant and equipment, net	265.9	255.3
Goodwill	239.9	222.6
Intangible assets	79.4	71.6
Deferred tax assets	106.4	147.3
Other assets	287.2	300.8
Total assets	\$3,171.8	\$ 3,294.4
Liabilities and Equity		
Current liabilities:		
Accounts payable	\$ 189.2	\$ 162.3
Accrued liabilities	379.0	374.9
Deferred revenues	790.2	755.4
Short-term borrowings	18.2	350.0
Current liabilities of discontinued operations	2.5	2.5
Total current liabilities	1,379.1	1,645.1
Other long-term liabilities	291.2	127.4
Total liabilities	1,670.3	1,772.5
Commitments and contingencies (Note 10)		
Equity:		
Varian stockholders' equity:		
Preferred stock of \$1 par value: 1.0 shares authorized; none issued and outstanding	—	—
Common stock of \$1 par value: 189.0 shares authorized; 91.5 and 91.7 shares issued and outstanding at June 29, 2018, and at September 29, 2017, respectively	91.5	91.7
Capital in excess of par value	771.8	716.1
Retained earnings	704.6	778.6
Accumulated other comprehensive loss	(70.7	) (68.8
Total Varian stockholders' equity	1,497.2	1,517.6
Noncontrolling interests	4.3	4.3
Total equity	1,501.5	1,521.9
Total liabilities and equity	\$3,171.8	\$ 3,294.4

See accompanying notes to the condensed consolidated financial statements.

VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

	Nine Months Ended	
	June 29, 2018	June 30, 2017
(In millions)		
Cash flows from operating activities:		
Net earnings	\$33.5	\$140.6
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Share-based compensation expense	34.0	32.7
Depreciation	38.3	45.2
Amortization of intangible assets	15.2	13.3
Deferred taxes	50.1	(15.9 )
Impairment charges	22.1	38.3
Loss on hedges related to acquisition-related activities	5.5	—
Provision for doubtful accounts receivable	2.7	38.5
Other, net	1.3	(0.7 )
Changes in assets and liabilities:		
Trade and unbilled receivables	10.8	25.8
Inventories	(48.5 )	(20.2 )
Prepaid expenses and other assets	(29.8 )	(49.0 )
Accounts payable	27.8	(0.6 )
Accrued liabilities and other long-term liabilities	150.0	(28.1 )
Deferred revenues	33.7	49.5
Net cash provided by operating activities	346.7	269.4
Cash flows from investing activities:		
Purchases of property, plant and equipment	(30.8 )	(40.4 )
Acquisitions, net of cash acquired	(58.7 )	(0.4 )
Issuance of notes receivable	—	(18.2 )
Principal payments on notes receivable	6.3	—
Investment in available-for-sale securities	(6.0 )	(9.1 )
Sale of available-for-sale securities	8.0	—
Loans to CPTC	(5.3 )	—
Purchase of foreign currency option related to acquisition-related activities	(5.5 )	—
Investment in privately-held companies	(10.1 )	(7.2 )
(Increase) decrease in restricted cash	(6.7 )	0.1
Other, net	(1.1 )	(3.7 )
Net cash used in investing activities	(109.9 )	(78.9 )
Cash flows from financing activities:		
Repurchases of common stock	(131.9 )	(269.1 )
Proceeds from issuance of common stock to employees	57.1	56.7
Employees' taxes withheld and paid for restricted stock, restricted stock units and performance units	(11.5 )	(10.6 )
Cash received from Varex Imaging Corporation	—	200.0
Cash and cash equivalents contributed to Varex Imaging Corporation	—	(54.2 )
Borrowings under credit facility agreement	503.3	148.0
Repayments under credit facility agreement	(503.3 )	(185.5 )
Net repayments under the credit facility agreements with maturities less than 90 days	(331.7 )	(262.0 )
Other	(3.6 )	1.0



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Net cash used in financing activities	(421.6 )	(375.7 )
Effects of exchange rate changes on cash and cash equivalents	4.6	1.7
Net decrease in cash and cash equivalents	(180.2 )	(183.5 )
Cash and cash equivalents at beginning of period	716.2	843.5
Cash and cash equivalents at end of period	\$536.0	\$660.0

See accompanying notes to the condensed consolidated financial statements.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Varian Medical Systems, Inc. ("VMS") and subsidiaries (collectively, the "Company") designs, manufactures, sells and services hardware and software products for treating cancer with radiotherapy, stereotactic radiosurgery, stereotactic body radiotherapy, and brachytherapy. Software solutions also include informatics software for information management, clinical knowledge exchange, patient care management, practice management and decision-making support for comprehensive cancer clinics, radiotherapy centers and medical oncology practices. The Company also develops, designs, manufactures, sells and services proton therapy products and systems for cancer treatment.

Distribution

On January 28, 2017 (the "Distribution Date"), the Company completed the separation and distribution (the "Distribution") of Varex Imaging Corporation ("Varex"), the Company's former Imaging Components business segment. On the Distribution Date, each of Varian's stockholder of record as of the close of business on January 20, 2017 (the "Record Date") received 0.4 of a share of Varex common stock for every one share of Varian common stock as of the Record Date. Varex is now an independent publicly traded company and is listed on The NASDAQ Global Select Market under the ticker "VREX." Varian continues to trade on the New York Stock Exchange under the ticker "VAR." See Note 2, "Discontinued Operations" for additional information.

Basis of Presentation

The condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP") have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements and the accompanying notes are unaudited and should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended September 29, 2017 (the "2017 Annual Report"). In the opinion of management, the condensed consolidated financial statements herein include adjustments (consisting only of normal recurring adjustments) necessary for a fair statement of the Company's financial position as of June 29, 2018 and September 29, 2017, results of operations and statements of comprehensive earnings for the three and nine months ended June 29, 2018 and June 30, 2017, and cash flows for the nine months ended June 29, 2018 and June 30, 2017. The results of operations for the nine months ended June 29, 2018 are not necessarily indicative of the operating results to be expected for the full fiscal year or any future period.

At the beginning of the Company's fiscal year 2018, the Company early adopted the new revenue recognition Accounting Standard Codification 606 "Revenues from Contracts with Customers" ("ASC 606") by using the full retrospective method. All financial statements and disclosures have been recast to comply with ASC 606. See "Recently Adopted Accounting Pronouncements" below for further information.

The historical financial position and results of operations of the Imaging Components business and costs relating to the Distribution are reported in the condensed consolidated financial statements as discontinued operations for all the periods presented. Information in the accompanying notes to the condensed consolidated financial statements have been recast to reflect the effect of the Distribution. The Condensed Consolidated Statements of Comprehensive Earnings and Cash Flows have not been recast to reflect the effect of the Distribution.

Fiscal Year

The fiscal years of the Company as reported are the 52- or 53-week periods ending on the Friday nearest September 30. Fiscal year 2018 is the 52-week period ending September 28, 2018. Fiscal year 2017 was the 52-week period that ended on September 29, 2017. The fiscal quarters ended June 29, 2018 and June 30, 2017 were both 13-week periods.



VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)  
(Unaudited)

#### Principles of Consolidation

The condensed consolidated financial statements include those of VMS and its wholly-owned and majority-owned or controlled subsidiaries. Intercompany balances, transactions and stock holdings have been eliminated in consolidation.

#### Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

#### Significant Accounting Policies

The Company's significant accounting policies are detailed in "Note 1: Summary of Significant Accounting Policies" within Item 8 of the Company's Annual Report on Form 10-K for the year ended September 29, 2017. Significant changes to these accounting policies as a result of adoption of ASC 606 are discussed below:

#### Revenue Recognition

The Company's revenues are derived primarily from the sale of radiotherapy and proton therapy hardware and software products, support, training and maintenance of all those products, installation services and the sale of parts. The Company accounts for a contract with a customer when there is approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable.

The Company's revenues are measured based on consideration specified in the contract with each customer, net of any sales incentives and amounts collected on behalf of third parties such as sales taxes. The Company recognizes revenues as the performance obligations are satisfied by transferring control of the product or service to a customer. The majority of the Company's revenue arrangements consist of multiple performance obligations including hardware, software, and services. Determining the stand-alone selling price ("SSP") and allocation of consideration from an arrangement to the individual performance obligations, and the appropriate timing of revenue recognition are significant judgments with respect to these arrangements.

The Company's products are generally not sold with a right of return, and the Company does not provide credits or incentives, which may be required to be accounted for as variable consideration when estimating the amount of revenue to be recognized.

The Company recognizes an asset for the incremental costs of obtaining a contract with a customer if the Company expects the benefit of those costs to be longer than one year. The Company applies a practical expedient to expense costs as incurred for costs to obtain a contract when the amortization period would have been one year or less. These costs mainly include the Company's internal sales force compensation program; under the terms of these programs, compensation is generally earned and the costs are recognized at the time the revenue is recognized.

The majority of the Company's products and services are sold in bundled arrangements (e.g., hardware, software, and services). For bundled arrangements, the Company accounts for individual products and services separately if they are distinct, that is, if a product or service is separately identifiable from other items in the bundled package and if a customer can benefit from it on its own or with other resources that are readily available to the customer. The consideration (including any discounts) is allocated between separate products and services in a bundle based on their individual SSP. The SSP is determined based on observable prices at which the Company separately sells the products and services. If an SSP is not directly observable, then the Company will estimate the SSP considering marketing conditions, entity-specific factors, and information about the customer or class of customer that is reasonably available.

VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)  
(Unaudited)

The following is a description of the principal activities, separated by reportable segment, from which the Company generates its revenues.

#### Oncology Systems

The Company's Oncology Systems linear accelerators are generally sold in a bundled arrangement with hardware and software accessory products that enhance efficiency and enable delivery of advanced radiotherapy and radiosurgery treatments; however, certain products are occasionally sold on a stand-alone basis. The majority of machine and software sales include installation services and training. Delivery of different elements in a revenue arrangement often span more than one reporting period. For example, a linear accelerator and software may be delivered in one reporting period, but the related installation of those products may be completed in a later period. Hardware and software extended maintenance and service contracts are occasionally sold during the initial product sale, but the majority are sold separately near or at the end of the initial warranty period. Revenues related to extended warranty and service contracts are earned after the expiration of the initial warranty period.

Payment terms and conditions vary by contract type, although terms are generally commensurate with a significant milestone, such as contract signing, shipment, delivery, acceptance or service commencement. In instances where the timing of revenue recognition differs from the timing of invoicing, the Company has determined its contracts generally do not include a significant financing component. The primary purpose of the Company's invoicing terms is to provide customers with simplified and predictable ways of purchasing the Company's products and services, rather than to receive financing from the Company's customers, such as invoicing at the beginning of a contract term with revenue recognized ratably over the contract period for a service contract. Payment terms can also vary based on the type of customer, such as government purchases. There are occasions where the Company provides extended payment terms in which case a portion of the transaction price is allocated to imputed interest income.

From time to time, the Company's contracts are modified to account for additional, or to change existing, performance obligations. The Company's contract modifications are generally accounted for prospectively.

#### Hardware Products and Installation

Hardware products may include software that the hardware is dependent on and highly interrelated with and cannot operate without. The Company typically has a standard base configuration for its hardware products, but there are typically multiple options and configuration choices. Revenues from the sale of hardware are recognized when the Company transfers control to the customer.

Product installation includes uncrating, moving the machine to the treatment room, connection and validating configuration. In addition, a number of testing protocols are completed to confirm the equipment is performing to the contracted specifications. The Company recognizes revenues for hardware installation over time as the customer receives and consumes benefits provided as the Company performs the installation services.

#### Software Products and Installation

Software products include information management, treatment planning, image processing, clinical knowledge exchange, patient care management, decision-making support, and practice management software. Software installation includes transferring software to the customer's computers, configuration of the software and potentially data migration. The Company recognizes revenues for software and software installation upon the customer's acceptance of the software and installation services.

#### Service

Service revenues include revenues from initial and extended software support agreements, extended hardware warranty agreements, training, paid service arrangements when a customer does not have an extended warranty and parts that are sold by the service department.

Revenues from hardware and software support agreements are accounted for ratably over the term of the agreement. Services and training revenues are recognized in the period the services and training are performed. Revenues for sales of parts are recognized when the parts are delivered to the customer and control is transferred.



VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)  
(Unaudited)

Warranties

The Company's sale of hardware includes a one-year warranty. The Company uses the cost accrual method to account for assurance-type warranties. The standard warranty provision further includes services in addition to an assurance-type warranty (for example, preventative maintenance inspections, help desk support, and when and if available operating system upgrades). These service-type warranty features are recorded as a separate performance obligation and recognized ratably over the one-year warranty period.

Varian Particle Therapy ("VPT")

The manufacturing of the major components of a proton therapy system, installation, and commissioning typically lasts 18 to 24 months. The Company's proton therapy system is highly customized. A proton therapy system typically includes hardware, software that the hardware is dependent upon and highly interrelated with, and without which the hardware cannot operate, and installation. The Company also sells software products that include information management, treatment planning, image processing, clinical knowledge exchange, patient care management, decision-making support, and practice management software, and software installation.

The Company provides operations and maintenance services related to the proton therapy system under a separate arrangement. These contracts are typically executed at or about the same time as the proton therapy system contracts; however, the pricing and performance of the proton therapy system contracts are not typically related to the pricing or performance of the operations and maintenance contracts. Therefore, the Company recognizes operations and maintenance services as a separate performance obligation.

Under the typical payment terms of the Company's fixed-price contracts, the customer pays the Company an up-front advance payment and then performance-based payments based on quantifiable measures of performance or on the achievement of specified events or milestones. Customers do not typically receive discounts in their overall selling price based on the amount and timing of milestone payments. As the revenue is recognized over time relative to the costs incurred and the customer billing milestones are typically event driven, this may result in revenue recognized in excess of billings at some point during the contract which the Company presents as unbilled receivables on the Condensed Consolidated Balance Sheets. Amounts billed and due from the Company's customers are classified as trade accounts receivable on the Condensed Consolidated Balance Sheets. In most contracts, the Company is entitled to receive an advance payment at the beginning of the contract. The Company recognizes a liability for these advance payments in excess of revenue recognized and presents it as deferred revenues on the Condensed Consolidated Balance Sheets. The advance payment typically is not considered a significant financing component because it is used to ensure the customer's commitment to the project and to provide assurance that the customer will perform its obligations under the contract.

The Company recognizes revenue for its proton therapy systems over time because the customer controls the work in process, the Company's performance does not create an asset with an alternative use to the Company, and the Company has an enforceable right to payment for performance completed to date.

Due to the nature of the work required to be performed on many of the Company's performance obligations, the estimation of total revenues and costs at completion is complex, subject to many variables and requires significant judgment. The Company's contracts generally do not include award fees, incentive fees or other provisions that may be considered variable consideration.

The Company has a standard quarterly progress review process in which management reviews the progress and execution of the Company's performance obligations. As part of this process, management reviews information including, but not limited to, any outstanding key contract matters, progress towards completion and the related program schedule, identified risks and the related changes in estimates of revenues and costs. The risks and opportunities include management's judgment about the ability and costs to achieve the schedule (e.g., the number and type of milestone events), technical and other contract requirements. Management must make assumptions and estimates regarding the complexity of the work to be performed, the availability of materials and outside services, the length of time to complete the performance obligation and labor and overhead cost rates, among other significant

judgments. Based on this analysis, any quarterly adjustments to revenues, cost of revenues, and the related impact to operating earnings are recognized as necessary in the period they become known on a cumulative catch-up basis. When estimates of total costs to be incurred on a performance obligation exceed total estimates of revenues to be earned, a provision for the entire loss on the performance obligation is recognized in the period the loss is determined. Similar to the Oncology Systems segment, the Company recognizes VPT revenues for software and installation upon completion and acceptance of the software and installation services.



VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
 NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)  
 (Unaudited)

Unfulfilled Performance Obligations for Oncology Systems and VPT

The following table represents the Company's unfulfilled performance obligations as of June 29, 2018 and the estimated revenue expected to be recognized in the future related to these unfulfilled performance obligations:

(In millions)	Fiscal years of revenue recognition			
	Remainder of 2018	2019	2020	Thereafter
Unfulfilled Performance Obligations	\$465.3	\$2,447.9	\$1,022.9	\$1,807.7

The table above includes both product and service unfulfilled performance obligations, which includes a component of service performance obligations which have not been invoiced. The fiscal years presented reflect management's best estimate of when the Company will transfer control to the customer and may change based on timing of shipment, readiness of customers' facilities for installation, installation requirements, and availability of products or customer acceptance terms.

As part of the Company's adoption of ASC 606, the Company elected to use the following practical expedients (i) to exclude disclosures of transaction prices allocated to remaining performance obligations when the Company expects to recognize such revenue for all periods prior to the date of initial application of ASC 606 (ii) not to adjust the promised amount of consideration for the effects of a significant financing component when the Company expects, at contract inception, that the period between the Company's transfer of a promised product or service to a customer and when the customer pays for that product or service will be one year or less (iii) to expense costs as incurred for costs to obtain a contract when the amortization period would have been one year or less, which mainly includes the Company's internal sales force compensation program and certain partner sales incentive programs (iv) not to recast revenue for contracts that begin and end in the same fiscal period, and (v) not to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract with the customer.

Contract Balances

The timing of revenue recognition, billings and cash collections results in trade and unbilled receivables, and deferred revenues on the Condensed Consolidated Balance Sheets. In Oncology Systems, the Company often collects an advance payment and the balance is typically billed on a combination of delivery and/or acceptance. In VPT, the Company usually collects an advance payment and additional amounts are billed as work progresses in accordance with agreed-upon contractual terms upon achievement of contractual milestones. Service contracts are usually billed at the beginning of the contract period or at periodic intervals (e.g. monthly or quarterly) during the contract which could result in a contract asset and contract liability. At times, billing occurs subsequent to revenue recognition, resulting in an unbilled receivable which represents a contract asset. However, when the Company receives advances or deposits from customers, which can be higher in the initial stages of the contract, particularly international contracts in the case of Oncology Systems, before revenue is recognized, this results in deferred revenues which represents a contract liability. These contract assets and liabilities are reported as unbilled receivables and deferred revenues, respectively, on the Condensed Consolidated Balance Sheet on a contract-by-contract basis at the end of each reporting period.

Recently Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASC 606. Under the standard, revenue is recognized when a customer obtains control of promised goods or services in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services. Effective September 30, 2017, the Company elected to early adopt the requirements of ASC 606 using the full retrospective method, which required the Company to recast the prior reporting periods presented.

The most significant impacts on adoption were in the Oncology Systems segment and are primarily due to the removal of the contingent revenue cap which limited revenue recognition to the amount of cash received from the customer, the elimination of the mandatory revenue deferral for software sold with extended payment terms and the removal of the vendor-specific objective evidence requirement for the separation of bundled software products. The Company

also identified additional performance obligations for training and certain elements of warranty that are recognized as separate performance obligations, and identified that certain new performance obligations were previously accounted for as part of hardware products and will result in a change in classification of revenues from product to service. In preparation for adoption of the standard, the Company implemented internal controls and key system functionalities to enable the preparation of financial information.

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The Company has recast its condensed consolidated financial statements from amounts previously reported due to the adoption of ASC 606. Select Condensed Consolidated Statements of Earnings line items, which reflect the adoption of ASC 606 are as follows:

(In millions, except per share amounts)	Three Months Ended June 30, 2017			Nine Months Ended June 30, 2017		
	As Previously Reported	Adjustments	As Adjusted	As Previously Reported	Adjustments	As Adjusted
Revenues:						
Product	\$383.4	\$ (63.2 )	\$ 320.2	\$1,113.1	\$ (118.8 )	\$ 994.3
Service	279.0	33.6	312.6	816.1	87.1	903.2
Total revenues	662.4	(29.6 )	632.8	1,929.2	(31.7 )	1,897.5
Cost of revenues:						
Product	248.4	(22.8 )	225.6	727.0	(48.3 )	678.7
Service	120.7	21.0	141.7	357.9	52.8	410.7
Total cost of revenues	369.1	(1.8 )	367.3	1,084.9	4.5	1,089.4
Gross margin	293.3	(27.8 )	265.5	844.3	(36.2 )	808.1
Earnings from continuing operations before taxes	116.5	(27.8 )	88.7	234.6	(36.2 )	198.4
Taxes on earnings	25.9	(7.1 )	18.8	60.2	(9.2 )	51.0
Net earnings from continuing operations	90.6	(20.7 )	69.9	174.4	(27.0 )	147.4
Net loss from discontinued operations	—	—	—	(6.8 )	—	(6.8 )
Net earnings	\$90.6	\$ (20.7 )	\$ 69.9	\$167.6	\$ (27.0 )	\$ 140.6
Net earnings attributable to Varian	\$90.4	\$ (20.7 )	\$ 69.7	\$166.9	\$ (27.0 )	\$ 139.9
Diluted net earnings per share from continuing operations attributable to Varian	\$0.98	\$ (0.23 )	\$ 0.75	\$1.86	\$ (0.29 )	\$ 1.57

Select Condensed Consolidated Statements of Balance Sheet line items, which reflect the adoption of ASC 606 are as follows:

(In millions)	September 29, 2017		
	As Previously Reported	Adjustments	As Adjusted
Assets:			
Trade and unbilled receivables, net	\$823.5	\$ 138.0	\$ 961.5
Inventories	439.7	(22.0 )	417.7
Prepaid expenses and other current assets	199.8	(9.5 )	190.3
Deferred tax assets	138.8	8.5	147.3
Liabilities and Equity:			
Accrued liabilities	394.7	(19.8 )	374.9
Deferred revenues	640.6	114.8	755.4
Other long-term liabilities	130.0	(2.6 )	127.4
Retained earnings	756.0	22.6	778.6

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In addition, the cumulative effect of ASC 606 to the Company's retained earnings at October 2, 2015 was \$56.7 million. Adoption of ASC 606 had no impact to net cash from or used in operating, investing or financing activities in the Company's Condensed Consolidated Statements of Cash Flows.

In the first quarter of fiscal year 2018, the Company elected to early adopt the FASB guidance which targeted improvements to the accounting for hedging activities. The guidance allows companies to more accurately present the economic effects of risk management activities in the financial statements. This amendment is required to be applied prospectively. The primary impact of the adoption is the required disclosure changes. The adoption of the new guidance did not have a material impact on the Company's condensed consolidated financial statements.

In the first quarter of fiscal year 2018, the Company adopted the FASB guidance related to employee share-based payments. The amendment simplifies several aspects of the accounting for employee share-based payments including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The Company elected to use the prospective transition method for the presentation of excess tax benefits on the statement of cash flows. Under the new standard, excess tax benefits are now included in taxes on earnings in the Consolidated Statements of Earnings. The Company elected to recognize forfeitures as they occur, and the impact of this change in accounting policy was recorded as a \$0.4 million reduction, net, to its beginning retained earnings balance as of September 30, 2017. See Note 12, "Income Taxes" for more information on the impact of this accounting guidance. The remaining provisions of this amendment did not have a material impact on the Company's condensed consolidated financial statements.

In the first quarter of fiscal year 2018, the Company adopted the FASB accounting guidance related to inventory measurement. The amendment requires inventory measured using first-in, first-out (FIFO) or average cost to be subsequently measured at the lower of cost and net realizable value, thereby simplifying the current guidance that requires an entity to measure inventory at the lower of cost or market. This amendment is required to be applied prospectively. The adoption of this new guidance did not have a material impact to the Company's condensed consolidated financial statements.

In the first quarter of fiscal year 2018, the Company elected to early adopt the FASB guidance on the definition of a business in accounting for transactions when determining whether they represent acquisitions or disposals of assets or of a business. The Company adopted this amendment prospectively. The adoption of this new guidance did not have an impact to the Company's condensed consolidated financial statements.

In the first quarter of fiscal year 2018, the Company elected to early adopt the FASB guidance simplifying the measurement of goodwill by eliminating the Step 2 impairment test. The new guidance requires companies to perform the goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. The Company adopted this amendment prospectively. The adoption of this new guidance did not have an impact to the Company's condensed consolidated financial statements.

#### Recent Accounting Standards or Updates Not Yet Effective

In February 2018, the FASB amended its guidance that will allow companies to reclassify disproportionate tax effects in accumulated other comprehensive income caused by the Tax Cuts and Jobs Act to retained earnings. The amendment will be effective for the Company beginning in its first quarter of fiscal year 2020. Early adoption is permitted. The Company is evaluating the impact of adopting this amendment to its condensed consolidated financial statements.

In May 2017, the FASB provided guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The guidance is effective for the Company beginning in the first quarter of fiscal 2019. Early adoption is permitted. The Company does not expect that the adoption of this guidance will have a material impact on its condensed consolidated financial statements.

In March 2017, the FASB amended its guidance on the accounting related to defined benefit plans and other post-retirement benefits. This amendment requires the service cost component of net periodic pension and post-retirement benefit cost be presented in the same line item as other employee compensation costs, while the other

components be presented separately as non-operating income (expense). The amendment will be effective for the Company beginning in its first quarter of fiscal year 2019. Early adoption is permitted. The Company is evaluating the impact of adopting this amendment to its condensed consolidated financial statements.

In November 2016, the FASB amended its guidance on the classification and presentation of restricted cash in the statement of cash flow. The amendment requires entities to include restricted cash and restricted cash equivalents in its cash and cash

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equivalents in the statement of cash flows. The amendment will be effective for the Company beginning in its first quarter of fiscal year 2019 with early adoption permitted. The amendment is required to be adopted retrospectively. The amendment is not expected to have a material impact to the Company's condensed consolidated financial statements.

In October 2016, the FASB amended its guidance for tax accounting for intra-entity asset transfers. The amendment removes the prohibition against the immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. The amendment will be effective for the Company beginning in its first quarter of fiscal year 2019. Early adoption is permitted. The amendment is required to be adopted on a modified retrospective basis. The Company is evaluating the impact of adopting this amendment to its condensed consolidated financial statements.

In August 2016, the FASB issued an amendment to its accounting guidance related to the classification of certain cash receipts and cash payments. The amendment was issued to reduce the diversity in practice in how certain transactions are classified in the statement of cash flows. The amendment will be effective for the Company beginning in its first quarter of fiscal year 2019 with early adoption permitted. The amendment is required to be adopted retrospectively unless it is impracticable. The Company is evaluating the impact of adopting this amendment to its condensed consolidated financial statements.

In June 2016, the FASB issued an amendment to its accounting guidance related to impairment of financial instruments. The amendment adds a new impairment model that is based on expected losses rather than incurred losses. The amendment will be effective for the Company beginning in its first quarter of fiscal year 2021 with early adoption permitted beginning in the first quarter of fiscal year 2020. The Company is evaluating the impact of adopting this amendment to its condensed consolidated financial statements.

In February 2016, the FASB issued a new standard on accounting for leases. The new standard is intended to provide enhanced transparency and comparability by requiring lessees to record right-of-use assets and corresponding lease liabilities on the balance sheet. The new standard will continue to classify leases as either finance or operating, with classification affecting the pattern of expense recognition in the statement of earnings. The new standard is required to be adopted using a modified retrospective method to each prior reporting period presented with various optional practical expedients. The new standard will be effective for the Company beginning in its first quarter of fiscal year 2020 with early adoption permitted. The Company is evaluating the impact of adopting this new standard to its condensed consolidated financial statements.

In January 2016, the FASB issued an amendment to its accounting guidance related to recognition and measurement of financial assets and financial liabilities. The amendment addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The amendment will be effective for the Company beginning in its first quarter of fiscal year 2019. The Company is evaluating the impact of adopting this amendment to its condensed consolidated financial statements.

## 2. DISCONTINUED OPERATIONS

On January 28, 2017, the Company completed the Distribution of Varex. In connection with the Distribution, the Company and Varex entered into a separation and distribution agreement as well as various other agreements that governs the relationships between the parties, including a transition services agreement, a tax matters agreement, an employee matters agreement, an intellectual property matters agreement, a trademark license agreement and supply/distribution agreements. The separation and distribution agreement and other agreements related to the separation were entered into on January 27, 2017. Services under the transition services agreement were for 60 days to 24 months following the Distribution Date, depending on the service provided.

On January 25, 2017, the Company entered into a term facility ("Varex Term Facility"), and on the same day drew down \$203.0 million under the facility. In conjunction with the Distribution, the Company used \$200.0 million of those proceeds to repay a portion of its outstanding 2013 Revolving Credit Facility. At the Distribution Date, the Company contributed \$81.3 million in cash and cash equivalents to Varex as part of the distribution and transfer of

certain legal entities. In fiscal year 2017, the Company received \$38.7 million from Varex for excess cash and cash equivalents contributed at the Distribution Date. In fiscal year 2017, the Company recorded a \$334.1 million reduction to retained earnings as a result of the Distribution of Varex, which included assets and liabilities transferred to Varex on the Distribution Date, including \$203.0 million of debt outstanding under the Varex Term Facility.

Following the Distribution, Varex retained a specified amount of cash that would enable Varex to pay the Company consideration for certain net assets outside of the United States that were required to be transferred to Varex but which did not occur on the Distribution Date due to not having received regulatory approvals for such transfers. Once those regulatory

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approvals are received, the Company will receive a cash payment from Varex in consideration for such net asset transfers. At June 29, 2018, the Company had \$1.9 million in assets (net of liabilities) on its Condensed Consolidated Balance Sheet related to Varex net assets to be transferred. The Company expects the remainder of Varex's net assets will be transferred in fiscal year 2018. If the Company does not receive the necessary regulatory approvals during a specified time period, Varex will be required to transfer such cash amounts to Varian.

The financial results of Varex are presented as net earnings from discontinued operations on the Condensed Consolidated Statements of Earnings, and primarily include the financial results of the Company's former Imaging Components operating segment and costs relating to the Distribution. Corporate costs previously allocated to the Company's Imaging Components operating segment are not included in discontinued operations. See Note 17, "Segment Information" for more information related to corporate allocated costs.

The following table summarizes the key components of net loss from discontinued operations:

(In millions)	Nine Months Ended (1) June 30, 2017
Revenues	\$194.0
Cost of revenues	117.3
Gross margin	76.7
Operating expenses (2)	76.1
Operating earnings	0.6
Taxes on earnings	7.4
Net loss from discontinued operations	(6.8 )
Less: Net earnings from discontinued operations attributable to noncontrolling interests	0.1
Net loss from discontinued operations attributable to Varian	\$(6.9 )

(1) There was no activity in net loss from discontinued operations during the three and nine months ended June 29, 2018 or the three months ended June 30, 2017.

Operating expenses include separation costs of \$34.2 million during the nine months ended June 30, 2017.

(2) Separation costs include expenses for transaction advisory services, consulting services, restructuring, and other expenses.

The following table summarizes the major classes of assets and liabilities of discontinued operations that were included in the Company's Condensed Consolidated Balance Sheets:

(In millions)	June 29, September 29, 2018 2017	
Assets:		
Trade accounts receivable, net	\$ 3.5	\$ 8.1
Inventories	0.5	2.9
Prepaid expenses and other current assets	0.4	0.1
Current assets of discontinued operations	4.4	11.1
Total assets of discontinued operations	\$ 4.4	\$ 11.1
Liabilities:		
Accounts payable	\$ 0.7	\$ 2.0
Accrued liabilities	1.8	0.5
Current liabilities of discontinued operations	2.5	2.5
Total liabilities of discontinued operations	\$ 2.5	\$ 2.5





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The following table presents supplemental cash flow information of discontinued operations:

	Nine Months Ended (1) June 30, 2017
(In millions)	
Operating activities:	
Share-based compensation expense	\$ 2.0
Depreciation expense	4.8
Amortization expense	1.8
Investing activities:	
Purchases of property, plant and equipment	\$ (6.4 )

(1) There was no significant cash flow activity from discontinued operations during the nine months ended June 29, 2018.

### 3. BUSINESS COMBINATIONS

#### Sirtex

On January 30, 2018, the Company signed an agreement to acquire Sirtex Medical Limited ("Sirtex"), an Australian company that is listed on the Australian Securities Exchange, for A\$28 per share or approximately A\$1.6 billion. On May 4, 2018, Sirtex received an unsolicited non-binding, indicative and conditional proposal from CDH Investments ("CDH"), a China-based alternative asset manager, for the acquisition of all of the issued shares in Sirtex for A\$33.60 per share. On June 14, 2018, the Company received notification from Sirtex that it had accepted the proposal from CDH and consequently, Sirtex terminated its agreement with the Company and the Company received a net \$9.0 million breakup fee from Sirtex.

#### Acquisitions

During the first nine months of fiscal year 2018, the Company acquired two privately-held software companies and a distributor of radiotherapy equipment, for an aggregate purchase price of \$58.7 million. The purchase price of all three acquisitions primarily consisted of \$22.8 million in finite-lived intangible assets and \$17.9 million in goodwill. The Company has integrated these three acquisitions into its Oncology Systems reporting unit.

#### Other Information

The excess of purchase price over the fair value amounts assigned to the assets acquired and liabilities assumed represents the goodwill amount resulting from the acquisitions completed above. The Company believes the factors that contributed to goodwill include synergies that are specific to the Company's acquisitions completed and not available to market participants and the acquisition of a talented workforce. The goodwill for the recent acquisitions mentioned above is deductible for income tax purposes.

The fair value of assets acquired and liabilities assumed has been determined on a preliminary basis, and the Company will finalize these amounts as it obtains the information necessary to complete the measurement process. Any changes resulting from facts and circumstances that existed as of the date of the acquisitions may result in adjustments to the amounts of goodwill, intangible assets and deferred revenue balances recorded. The Company expects to finalize these amounts no later than one year from the date of each acquisition.

The condensed consolidated financial statements include the operating results from the date of acquisition. The impact of the acquisitions completed to the periods presented was not material. Pro forma results of operations for the acquisitions completed have not been presented because the effects of the acquisitions, individually and in the aggregate, were not material to the Company's condensed consolidated financial statements.

During the three and nine months ended June 29, 2018, the Company incurred acquisition-related expenses of \$12.7 million and \$33.9 million, respectively, which includes losses of \$13.3 million and \$29.7 million, respectively, related to hedging the anticipated Australian dollar purchase price for Sirtex; as well as acquisition costs of \$8.4 million and \$13.2 million,

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respectively; partially offset by a net \$9.0 million breakup fee received from Sirtex in connection with the termination of the acquisition. See Note 9, "Derivative Instruments and Hedging Activities" for further information on the hedging losses.

#### 4. BALANCE SHEET COMPONENTS

The following table provides the Company's unbilled receivables and deferred revenues from contracts with customers:

(In millions)	June 29, September 29,	
	2018	2017
Unbilled receivables - current	\$343.0	\$ 259.1
Unbilled receivables - long-term <sup>(1)</sup>	27.4	10.9
Deferred revenues - current	(790.2 )	(755.4 )
Deferred revenues - long-term <sup>(2)</sup>	(9.6 )	(7.2 )
Total net unbilled receivables (deferred revenues)	\$(429.4)	\$ (492.6 )

<sup>(1)</sup> Included in other assets on the Company's Condensed Consolidated Balance Sheets.

<sup>(2)</sup> Included in other long-term liabilities on the Company's Condensed Consolidated Balance Sheets.

During the nine months ended June 29, 2018, unbilled receivables net of deferred revenues increased by \$63.2 million primarily due to the contractual timing of billings occurring after the revenues were recognized, as well as the timing of milestone payments.

During the three and nine months ended June 29, 2018, the Company recognized revenues of \$214.3 million and \$519.5 million, respectively, which was included in the deferred revenues balance at September 29, 2017. During the three and nine months ended June 30, 2017, the Company recognized revenues of \$109.0 million and \$455.0 million, respectively, which was included in the deferred revenues balance at September 30, 2016.

The Company did not have any impairment losses on its unbilled receivables during the nine months ended June 29, 2018. The Company recognized an impairment loss of \$17.2 million from long-term unbilled receivables during the nine months ended June 30, 2017. See Note 16, "VPT Loans and Investment" for further information.

The following table summarizes the Company's inventories:

(In millions)	June 29, September 29,	
	2018	2017
Raw materials and parts	\$ 334.4	\$ 296.5
Work-in-process	54.2	47.7
Finished goods	80.6	73.5
Total inventories	\$ 469.2	\$ 417.7

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The following tables summarize the Company's cash equivalents and available-for-sale securities:

(In millions)	June 29, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash equivalents:				
Money market funds	\$ 155.8	\$ —	\$ —	\$ 155.8
Total cash equivalents	\$ 155.8	\$ —	\$ —	\$ 155.8
Available-for-sale securities:				
APTC securities <sup>(1)</sup>	\$ 6.3	\$ —	\$ —	\$ 6.3
GPTC securities <sup>(2)</sup>	4.6	—	—	4.6
Total available-for-sale securities	\$ 10.9	\$ —	\$ —	\$ 10.9

(In millions)	September 29, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
Original CPTC loans <sup>(2)</sup>	\$ 47.4	\$ —	\$ —	\$ 47.4
DRTC securities <sup>(2)</sup>	8.3	—	—	8.3
GPTC securities <sup>(2)</sup>	4.4	—	—	4.4
Total available-for-sale securities	\$ 60.1	\$ —	\$ —	\$ 60.1

(1) Included in prepaid and other current assets on the Company's Condensed Consolidated Balance Sheets because the Company has the ability and intent to sell this security in the next twelve months.

Included in other assets on the Company's Condensed Consolidated Balance Sheets because the maturity dates are

(2) greater than one year and the Company does not have the intent and ability to collect or sell all or a portion of its loans or securities in the next twelve months.

See Note 5, "Fair Value" and Note 16, "VPT Loans and Investment" for more information on the Original California Proton Treatment Center, LLC ("Original CPTC") Loans, Alabama Proton Therapy Center ("APTC"), Delray Radiation Therapy Center ("DRTC"), and Georgia Proton Treatment Center ("GPTC") Securities.

The following table summarizes the Company's other long-term liabilities:

(In millions)	June 29, September 29,	
	2018	2017
Long-term income taxes payable	\$ 201.1	\$ 48.6
Deferred income taxes	28.1	17.1
Other	62.0	61.7
Total other long-term liabilities	\$ 291.2	\$ 127.4

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## 5. FAIR VALUE

## Assets/Liabilities Measured at Fair Value on a Recurring Basis

In the tables below, the Company has segregated all assets and liabilities that are measured at fair value on a recurring basis into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the measurement date.

Type of Instruments	Fair Value Measurement Using			Total
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
(In millions)				
Assets at June 29, 2018:				
Cash equivalents:				
Money market funds	\$155.8	\$ —	\$ —	\$155.8
Available-for-sale securities:				
APTC securities	—	6.3	—	6.3
GPTC securities	—	4.6	—	4.6
Total assets measured at fair value	\$155.8	\$ 10.9	\$ —	\$166.7
Liabilities at June 29, 2018:				
Contingent consideration	\$—	\$ —	\$ (3.0 )	\$(3.0 )
Total liabilities measured at fair value	\$—	\$ —	\$ (3.0 )	\$(3.0 )
Assets at September 29, 2017:				
Available-for-sale securities:				
Original CPTC loans	\$—	\$ —	\$ 47.4	\$47.4
DRTC securities	—	8.3	—	8.3
GPTC securities	—	4.4	—	4.4
Total assets measured at fair value	\$—	\$ 12.7	\$ 47.4	\$60.1

The Company classifies its money market funds as Level 1 because they have daily liquidity, quoted prices for the underlying investments can be obtained, and there are active markets for the underlying investments. The Company's Level 2 available-for-sale securities consist of bonds for APTC, GPTC, and DRTC. The observable inputs for these securities are comparable bond issues, broker/dealer quotations for the same or similar investments in active markets and other observable inputs such as yields, credit risks, default rates, and volatility. As of June 29, 2018 and September 29, 2017, the carrying amount of the Level 2 available-for-sale securities approximated their fair value. See Note 16, "VPT Loans and Investment" for further information about these bonds.

The Company has elected to use the income approach to value its derivative instruments using standard valuation techniques and Level 2 inputs, such as currency spot rates, forward points and credit default swap spreads. The Company's derivative instruments are generally short-term in nature, typically one month to thirteen months in duration. See Note 9, "Derivative Instruments and Hedging Activities" for more information about the Company's

derivative instruments.

The Company measures the fair value of its Level 3 contingent consideration liabilities based on the income approach by using a discounted cash flow model with key assumptions that include estimated sales units or revenues of the acquired business or completion of certain milestone targets during the earn-out period, volatility, and estimated discount rates corresponding to the periods of expected payments. If the estimated sales units, revenues or probability of completing certain milestones were to increase or decrease during the respective earn-out period, the fair value of the contingent consideration would increase or decrease, respectively. If the estimated discount rates were to increase or decrease, the fair value of contingent consideration would decrease or increase, respectively. Changes in volatility may result in an increase or decrease in the fair value of contingent consideration. The Company's contingent consideration are from its business combinations in fiscal year 2018 and is included in accrued liabilities and other long-term liabilities on the Condensed Consolidated Balance Sheets.

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In December 2017, the Original CPTC loans were modified and partially satisfied resulting in a Term Loan of \$53.5 million, as defined in Note 16, "VPT Loans and Investment". One of the modifications was that the loan agent no longer has the option to purchase these loans from the Company; therefore, the Original CPTC loans are no longer classified as an available-for-sale security. The Company had no unrealized gains or unrealized losses associated with the Original CPTC loans recorded in its other comprehensive earnings. The modification to the Original CPTC Loans had no impact on the Company's Condensed Consolidated Statements of Earnings for the three months ended December 29, 2017. As of September 29, 2017, the Company classified the Original CPTC loans as available-for-sale securities, the fair value of which was based on the income approach by using the discounted cash flow model with key assumptions that include discount rates corresponding to the terms and risks associated with the loans as well as underlying cash flow assumptions. However, the Company did not increase the fair value of the Original CPTC loans above their par values as ORIX Capital Markets, LLC ("ORIX"), the loan agent, had the option to purchase these loans from the Company under the original terms and conditions at par value.

The following table presents the reconciliation for all assets and liabilities measured and recorded at fair value on a recurring basis using significant unobservable inputs (Level 3):

(In millions)	Available-for-sale Securities	Contingent Consideration
Balance at September 29, 2017	\$ 47.4	\$ —
Additions from business combinations	—	(3.0 )
Reclassification of Original CPTC Loans to Term Loan	(47.4 )	—
Balance at June 29, 2018	\$ —	\$ (3.0 )

There were no transfers of assets or liabilities between fair value measurement levels during either the three and nine months ended June 29, 2018, or the three and nine months ended June 30, 2017. Transfers between fair value measurement levels are recognized at the end of the reporting period.

## Fair Value of Other Financial Instruments

The fair values of certain of the Company's financial instruments, including bank deposits included in cash and cash equivalents, trade and unbilled receivables, net of allowance for doubtful accounts, short-term notes receivable, revolving loan to CPTC, RPTC senior secured debt, accounts payable, and short-term borrowings approximate their carrying amounts due to their short maturities.

As of June 29, 2018, the fair value of the Term Loan with CPTC approximated its carrying value of \$44.0 million. See Note 16, "VPT Loans and Investment" for further information. The carrying value is based on the present value of expected future cash payments discounted at a rate reflecting the nature and duration of the loans, risks involved with CPTC, and its industry. As a result, the Term Loan is categorized as Level 3 in the fair value hierarchy.

The fair value of the outstanding long-term notes receivable, including accrued interest, approximated their carrying value of \$51.6 million and \$100.2 million at June 29, 2018 and September 29, 2017, respectively, because they are based on terms of recent comparable transactions and are categorized as Level 3 in the fair value hierarchy. The fair value is based on the income approach by using the discounted cash flow model with key assumptions that include discount rates corresponding to the terms and risks as well as underlying cash flow assumptions. See Note 16, "VPT Loans and Investment" for information on the long-term notes receivable.



VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
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## 6. RECEIVABLES

The following table summarizes the Company's trade and unbilled receivables, net and notes receivable:

(In millions)	June 29, 2018	September 29, 2017
Trade and unbilled receivables, gross	\$ 1,004.5	\$ 1,039.2
Allowance for doubtful accounts	(40.3 )	(63.1 )
Trade and unbilled receivables, net	\$ 964.2	\$ 976.1
Short-term	\$ 933.6	\$ 961.5
Long-term <sup>(1)</sup>	\$ 30.6	\$ 14.6
Notes receivable	\$ 76.7	\$ 105.2
Short-term <sup>(2)</sup>	\$ 25.1	\$ 5.0
Long-term <sup>(1) (3)</sup>	\$ 51.6	\$ 100.2

<sup>(1)</sup> Balances are included in other assets on the Company's Condensed Consolidated Balance Sheets.

<sup>(2)</sup> Balances are included in prepaid expenses and other current assets on the Company's Condensed Consolidated Balance Sheets.

<sup>(3)</sup> Balances include accrued interest and are recorded in other assets on the Company's Condensed Consolidated Balance Sheets.

A financing receivable represents a financing arrangement with a contractual right to receive money, on demand or on fixed or determinable dates, and that is recognized as an asset on the Company's Condensed Consolidated Balance Sheets. The Company's financing receivables consist of trade receivables with contractual maturities of more than one year and notes receivable. A small portion of the Company's financing trade receivables are included in short-term trade accounts receivable.

As of June 29, 2018, the allowance for doubtful accounts is entirely related to short-term trade and unbilled receivables. As of September 29, 2017, the allowance for doubtful accounts included \$45.9 million related to short-term trade and unbilled receivables and \$17.2 million related to long-term unbilled receivables, which was written off in the first quarter of fiscal year 2018.

See Note 16, "VPT Loans and Investment" for more information on the Company's short-term and long-term notes receivable balances.

## 7. GOODWILL AND INTANGIBLE ASSETS

The following table reflects the activity of goodwill by reportable operating segment:

(In millions)	Oncology Systems	Varian Particle Therapy	Total
Balance at September 29, 2017	\$ 170.2	\$ 52.4	\$ 222.6
Business combinations	17.9	—	17.9
Foreign currency translation adjustments	—	(0.6 )	(0.6 )
Balance at June 29, 2018	\$ 188.1	\$ 51.8	\$ 239.9

See Note 3, "Business Combinations" for more information on the Company's acquisitions in fiscal year 2018.

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The following table reflects the gross carrying amount and accumulated amortization of the Company's intangible assets:

(In millions)	June 29, 2018			September 29, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Technologies and patents	\$115.5	\$ (70.6 )	\$ 44.9	\$102.0	\$ (60.9 )	\$ 41.1
Customer contracts and supplier relationship	42.8	(17.6 )	25.2	33.9	(14.3 )	19.6
Other	5.7	(5.2 )	0.5	5.5	(3.4 )	2.1
Total intangible with finite lives	164.0	(93.4 )	70.6	141.4	(78.6 )	62.8
In-process research and development with indefinite lives	8.8	—	8.8	8.8	—	8.8
Total intangible assets	\$172.8	\$ (93.4 )	\$ 79.4	\$150.2	\$ (78.6 )	\$ 71.6

Amortization expense for intangible assets was \$4.8 million and \$4.2 million during the three months ended June 29, 2018 and June 30, 2017, respectively, and \$15.2 million and \$11.5 million during the nine months ended June 29, 2018 and June 30, 2017, respectively.

As of June 29, 2018, the Company estimates its remaining amortization expense for intangible assets with finite lives will be as follows (in millions):

Fiscal Years:	Remaining Amortization Expense
Remainder of 2018	\$ 4.7
2019	16.3
2020	14.0
2021	10.6
2022	9.2
Thereafter	15.8
Total remaining amortization for intangible assets	\$ 70.6

## 8. BORROWINGS

The following table summarizes the Company's total short-term borrowings:

(In millions, except for percentages)	June 29, 2018			September 29, 2017		
	Amount	Weighted-Average Interest Rate		Amount	Weighted-Average Interest Rate	
Short-term borrowings:						
Sumitomo Credit Facility	\$18.2	0.53 %		\$—	— %	
2017 Revolving Credit Facility	—	— %		350.0	2.36 %	
Total short-term borrowings	\$18.2			\$350.0		

On April 3, 2018, the Company entered into a credit agreement (the "2018 Credit Agreement") with certain lenders and Bank of America, N.A. ("BoFA"), as the administrative agent. The 2018 Credit Agreement provides for a five-year revolving credit facility (the "2018 Revolving Credit Facility") in an aggregate principal amount of up to \$1.8 billion. The 2018 Revolving Credit Facility also includes a \$50.0 million sub-facility for the issuance of letters of credit and permits swing line loans of up to \$25 million. Under the 2018 Revolving Credit Facility, the Company has the right to (i) request to increase the aggregate commitments by an aggregate amount for all such requests of up to \$100.0 million and (ii) request an additional increase in the commitments or establish one or more term loans, provided that, in each case, the lenders are willing to provide such new or



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increased commitments and certain other conditions are met. The proceeds of the 2018 Revolving Credit Facility may be used for working capital, capital expenditures, Company share repurchases, permitted acquisitions and other corporate purposes, as well as to satisfy the prior outstanding obligation under the 2017 Revolving Credit Facility.

The 2018 Revolving Credit Facility replaced the 2017 Revolving Credit Facility of \$600 million. As of June 29, 2018, the Company did not have an outstanding principal balance on its 2018 Revolving Credit Facility.

Borrowings under the 2018 Revolving Credit Facility accrue interest based on either (i) the Eurodollar Rate plus a margin of 1.000% to 1.375% based on a net leverage ratio involving funded indebtedness and EBITDA, or (ii) a base rate of (a) the federal funds rate plus 0.50%, (b) BofA's announced prime rate, or (c) the Eurodollar Rate plus 1.00%, whichever is highest, plus a margin of 0.000% to 0.375% based on the same leverage ratio, depending upon instructions from the Company. Borrowings under the 2018 Revolving Credit Facility have a contract repayment date of twelve months, or less, and a final maturity of five years if based on the Eurodollar Rate and all overnight borrowings on the base rate would also have a final maturity of five years.

The Company must pay a commitment fee on the unused portion of the 2018 Revolving Credit Facility at a rate from 0.125% to 0.25% based on a net leverage ratio. The Company may prepay, reduce or terminate the commitments without penalty. Swing line loans under the 2018 Revolving Credit Facility will bear interest at the base rate plus the then applicable margin for base rate loans.

The 2018 Credit Agreement provides that certain material domestic subsidiaries must guarantee the 2018 Revolving Credit Facility, subject to certain limitations on the amount secured. As of June 29, 2018, no subsidiary guaranties were required to be executed under the 2018 Credit Agreement.

The 2018 Credit Agreement contains provisions that limit the Company's ability to, among other things, incur future indebtedness, contingent obligations or liens, guarantee indebtedness, make certain investments and capital expenditures, sell stock or assets and pay dividends, and consummate certain mergers or acquisitions.

The 2018 Credit Agreement contains affirmative and negative covenants applicable to the Company and its subsidiaries that are typical for credit facilities of this type, and that are subject to materiality and other qualifications, carve-outs, baskets and exceptions. The Company agreed to maintain a financial covenant which requires a maximum consolidated net leverage ratio. The Company was in compliance with all financial covenants under the 2018 Credit Agreement for all periods within these condensed consolidated financial statements.

VMS's Japanese subsidiary ("VMS KK") has an unsecured uncommitted credit agreement with Sumitomo that enables VMS KK to borrow and have outstanding at any given time a maximum of 3.0 billion Japanese Yen (the "Sumitomo Credit Facility"). In February 2018, the Sumitomo Credit Facility was extended and will expire in February 2019.

Borrowings under the Sumitomo Credit Facility accrue interest based on the basic loan rate announced by the Bank of Japan plus a margin of 0.5%.

#### 9. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company measures all derivatives at fair value on the Condensed Consolidated Balance Sheets. The accounting for gains or losses resulting from changes in the fair value of those derivatives depends upon the use of the derivative and whether it qualifies for hedge accounting.

At June 29, 2018, and September 29, 2017, the Company did not have any outstanding derivatives designated as hedging instruments. Derivatives not designated as hedging instruments were not material for any of the periods presented. See Note 5, "Fair Value" for the valuation of the Company's derivative instruments. Also, see Note 1, "Summary of Significant Accounting Policies" in the Consolidated Financial Statements in the Company's 2017 Annual Report for the credit risk associated with the Company's derivative instruments.

#### Offsetting of Derivatives

The Company presents its derivative assets and derivative liabilities on a gross basis on the Condensed Consolidated Balance Sheets. However, under agreements containing provisions on netting with certain counterparties of foreign exchange contracts, subject to applicable requirements, the Company is allowed to net-settle transactions in the same currency, with a single net amount payable by one party to the other. As of June 29, 2018, and September 29, 2017,

there were no potential effects of rights

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of setoff associated with derivative instruments. The Company is neither required to pledge nor entitled to receive cash collateral related to these derivative transactions.

Cash Flow Hedging Activities

The Company has many transactions denominated in foreign currencies and addresses certain of those financial exposures through a risk management program that includes the use of derivative financial instruments. The Company sells products throughout the world, often in the currency of the customer's country, and may hedge certain of the larger foreign currency transactions when they are either not denominated in the relevant subsidiary's functional currency or the U.S. Dollar. These foreign currency sales transactions are hedged using foreign currency forward contracts. The Company may use other derivative instruments in the future. The Company does not enter into foreign currency forward contracts for speculative or trading purposes. Foreign currency forward contracts are entered into up to several times a quarter and range from one to thirteen months in maturity.

The hedges of foreign currency denominated forecasted revenues are designated and accounted for as cash flow hedges. The designated cash flow hedges de-designate when the anticipated revenues associated with the transactions are recognized and the change in fair value of the derivatives is accumulated other comprehensive loss on the Condensed Consolidated Balance Sheets is reclassified to revenues in the Condensed Consolidated Statements of Earnings. Subsequent changes in fair value of the derivative instrument are recorded in selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings to offset changes in fair value of the resulting non-functional currency receivables. For derivative instruments that are designated and qualified as cash flow hedges, the Company formally documents for each derivative instrument at the hedge's inception, the relationship between the hedging instrument (foreign currency forward contract) and hedged item (forecasted foreign currency revenues), the nature of the risk being hedged and its risk management objective and strategy for undertaking the hedge. The Company records the gain or loss on the derivative instruments that are designated and qualified as cash flow hedges in accumulated other comprehensive loss on the Condensed Consolidated Balance Sheets and reclassifies these amounts into revenues in the Condensed Consolidated Statements of Earnings in the period in which the hedged transaction is recognized in earnings. The Company assesses hedge effectiveness both at the onset of the hedge and on an ongoing basis using regression analysis. The time value of the derivative and hedged item is included in the assessment of hedge effectiveness.

At the inception of the hedge relationship and quarterly thereafter, the Company assesses whether the likelihood of meeting the forecasted cash flow is highly probable. As of June 29, 2018 and September 29, 2017, the Company did not have any outstanding foreign currency forward contracts designated as cash flow hedges.

During the nine months ended June 29, 2018, the Company recognized an unrealized loss of \$0.9 million, in other comprehensive earnings on foreign currency forward contracts designated as cash flow hedges. The Company did not have any foreign currency forward contracts designated as cash flow hedges during the three months ended June 29, 2018 and the three and nine months ended June 30, 2017.

The effect of cash flow hedge accounting on the Condensed Consolidated Statements of Earnings was as follows:

Location and  
 Amount  
 Recognized  
 in Earnings  
 on Cash Flow  
 Hedging  
 Relationships  
 Nine Months  
 Ended  
 June 29,  
 2018

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(In millions)

	Revenues
Total amounts of income and expense line items presented in the Condensed Consolidated Statements of Earnings in which the effects of fair value and cash flow hedges are recorded	\$ 2,117.5
Loss on cash flow hedge relationships:	
Foreign currency forward contracts:	
Amount of loss reclassified from accumulated other comprehensive loss into earnings	\$ (0.9 )

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
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Balance Sheet Hedging Activities

The Company also hedges balance sheet exposures from its various subsidiaries and business units where the U.S. Dollar is the functional currency. The Company enters into foreign currency forward contracts to minimize the short-term impact of foreign currency fluctuations on monetary assets and liabilities denominated in currencies other than the U.S. Dollar functional currency. The foreign currency forward contracts are short term in nature, typically with a maturity of approximately one month, and are based on the net forecasted balance sheet exposure. For derivative instruments not designated as hedging instruments, changes in their fair values are recognized in selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings. Changes in the values of these hedging instruments are offset by changes in the values of foreign-currency-denominated assets and liabilities. Variations from the forecasted foreign currency assets or liabilities, coupled with a significant currency rate movement, may result in a material gain or loss if the hedges are not effectively offsetting the change in value of the foreign currency asset or liability. Other than foreign exchange hedging activities, the Company has no other free-standing or embedded derivative instruments.

The Company had the following outstanding foreign currency forward contracts relating to balance sheet hedging activities:

(In millions)	June 29, 2018	
	Notional	
	Value Sold	Value Purchased
Australian Dollar	\$26.9	\$ —
Brazilian Real	11.2	—
British Pound	31.4	0.7
Danish Krone	7.8	0.6
Euro	253.5	8.3
Hungarian Forint	2.7	—
Indian Rupee	17.7	—
Japanese Yen	43.0	—
Norwegian Krone	0.5	—
Polish Zloty	12.4	—
Singapore Dollar	—	0.3
South African Rand	8.2	—
Swedish Krona	4.9	—
Swiss Franc	—	38.7
Taiwan Dollar	5.4	—
Thai Baht	6.1	—
Totals	\$431.7	\$ 48.6

The following table presents the gains (losses) recognized in the Condensed Consolidated Statements of Earnings related to the foreign currency forward contracts that are not designated as hedging instruments.

Location of Gain (Loss) Recognized in Net Earnings on Derivative Instruments	Amount of Gain (Loss) Recognized in Net Earnings on Derivative Instruments			
	Three Months Ended		Nine Months Ended	
	June 29, 2018	June 30, 2017	June 29, 2018	June 30, 2017
(In millions)				
Selling, general and administrative expenses	\$25.5	\$ (9.9 )	\$13.3	\$ (2.5 )



The gains (losses) on these derivative instruments were significantly offset by the gains (losses) resulting from the re-measurement of monetary assets and liabilities denominated in currencies other than the U.S. Dollar functional currency.

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Foreign Currency Forward and Option Contracts related to Sirtex

In February 2018, the Company entered into foreign currency forward contracts and a foreign currency option contract to economically hedge its foreign currency exchange rate risk on the consideration to be paid for the anticipated Sirtex acquisition. The foreign currency forward contracts allowed the Company to purchase a notional amount of A\$793.0 million for \$621.0 million on May 25, 2018. On May 25, 2018, the Company purchased the off-setting foreign currency forward contracts for a notional amount of \$596.8 million. Also in February 2018, the Company paid a premium of \$5.5 million for a foreign currency option that allowed the Company the right to purchase a notional amount of A\$792.0 million for \$641.5 million, which expired on May 23, 2018. Since the Company did not acquire Sirtex, the foreign currency option was not exercised.

The foreign currency forward contracts and option contract did not qualify for hedge accounting. As such, changes in the fair value were recognized in acquisition-related expenses on the Condensed Consolidated Statements of Earnings. In the three and nine months ended June 29, 2018, the Company recorded losses of \$12.8 million and \$24.2 million on the foreign currency forward contracts and \$0.5 million and \$5.5 million on the foreign currency option contract.

Contingent Features

Certain of the Company's derivative instruments are subject to master agreements which contain provisions that require the Company, in the event of a default, to settle the outstanding contracts in net liability positions by making settlement payments in cash or by setting off amounts owed to the counterparty against any credit support or collateral held by the counterparty. As of June 29, 2018, and September 29, 2017, the Company did not have any outstanding derivative instruments with credit-risk-related contingent features that were in a net liability position in the Company's outstanding balance sheet hedges.

10. COMMITMENTS AND CONTINGENCIES

Product Warranty

The following table reflects the changes in the Company's accrued product warranty:

(In millions)	Nine Months Ended	
	June 29, 2018	June 30, 2017
Accrued product warranty, at beginning of period	\$41.3	\$41.9
Charged to cost of revenues	41.8	29.4
Actual product warranty expenditures	(41.6 )	(32.8 )
Accrued product warranty, at end of period	\$41.5	\$38.5

Accrued product warranty was included in accrued liabilities and other long-term liabilities on the Condensed Consolidated Balance Sheets.

Contingencies

Environmental Remediation Liabilities

The Company's operations and facilities, past and present, are subject to environmental laws, including laws that regulate the handling, storage, transport and disposal of hazardous substances. Certain of those laws impose cleanup liabilities on the Company in connection with its past and present operations. Those include facilities sold as part of the Company's electron devices business in 1995 and thin film systems business in 1997. As a result, the Company oversees various environmental cleanup projects and receives reimbursements from third parties for a portion of the costs of its cleanup activities.

The Company also reimburses certain third parties for cleanup activities. The Company spent \$0.2 million and \$0.2 million (net of amounts borne by third parties) in the three months ended June 29, 2018 and June 30, 2017, respectively, on environmental cleanup costs, third-party claim costs, project management costs and legal costs. The Company spent \$0.6 million and \$0.5 million (net of amounts borne by third parties) in the nine months ended June 29, 2018 and June 30, 2017, respectively, on such costs.



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With respect to some of these facilities, inherent uncertainties make it difficult to estimate the likelihood of the cost of future cleanup, third-party claims, project management and legal services for the cleanup sites (“Group A Sites”). Nonetheless, as of June 29, 2018, the Company estimated that, net of third parties’ indemnification obligations, future costs associated with the environmental remediation liabilities for the Group A Sites would range in total from \$0.8 million to \$5.3 million. The time frames over which these cleanup project costs are estimated vary, ranging from one year to thirty years as of June 29, 2018. Management believes that no amount in that range is more probable of being incurred than any other amount and therefore accrued \$0.8 million for these cleanup projects as of June 29, 2018. The accrued amount has not been discounted to present value due to the uncertainties that make it difficult to develop a single best estimate.

In addition to the Group A Sites, there are other past and present facilities (“Group B Sites”) where the Company believes it has gained sufficient knowledge to better estimate the scope and cost of monitoring, cleanup and management activities. This, in part, is based on agreements with other parties and also cleanup plans approved by or completed in accordance with the requirements of, the governmental agencies having jurisdiction. As of June 29, 2018, the Company estimated that the Company’s future exposure on the Group B Sites, net of third parties’ indemnification obligations, for the costs at these facilities, and reimbursements of third-party’s claims for these facilities, ranged in total from \$3.9 million to \$18.1 million. The time frames over which these costs are estimated to be incurred vary, ranging from one year to thirty years as of June 29, 2018. As to each of these facilities, management determined that a particular amount within the range of estimated costs was a better estimate than any other amount within the range, and that the amount and timing of these future costs were reliably determinable. The best estimate within that range was \$5.3 million at June 29, 2018. Accordingly, the Company had accrued \$4.7 million as of June 29, 2018 for these costs, which represented the best estimate discounted at 4%, net of inflation. This accrual is in addition to the \$0.8 million accrued for the Group A Sites.

These amounts are only estimates of anticipated future costs. The amounts the Company will actually spend may be greater than the estimates. The Company believes its reserve is adequate; however, as the scope of the Company’s obligations becomes more clearly defined, the Company may modify the reserve, and charge or credit future earnings accordingly. Based on information currently known to management, management believes the costs of these environmental-related matters are not reasonably likely to have a material adverse effect on the consolidated financial statements of the Company in any one fiscal year.

The Company evaluates its liability for investigation and cleanup costs in light of the obligations and financial strength of potential third parties and insurance companies the Company believes it has rights to indemnity or reimbursement. The Company has an agreement with an insurance company under which that insurer has agreed to pay a portion of the Company’s past and future environmental-related expenditures. Receivables, net of the portion due to third parties who reimburse the Company, from that insurer amounted to \$1.5 million and \$1.6 million at June 29, 2018 and September 29, 2017, respectively, with the respective current portion included in prepaid expenses and other current assets and the respective noncurrent portion included in other assets. The payable portion to that insurer is included in other long-term liabilities on the Condensed Consolidated Balance Sheets. The Company believes that this receivable is recoverable because it is based on a binding, written settlement agreement with an insurance company who appears to be financially viable and who has paid the Company’s claims in the past.

#### Other Matters

From time to time, the Company is a party to or otherwise involved in legal proceedings, claims and government inspections or investigations and other legal matters, both inside and outside the United States, arising in the ordinary course of its business or otherwise. The Company accrues amounts, to the extent they can be reasonably estimated, that it believes are adequate to address any liabilities related to legal proceedings and other loss contingencies that the Company believes will result in a probable loss (including, among other things, probable settlement value). A loss or a range of loss is disclosed when it is reasonably possible that a material loss will be incurred and can be estimated or when it is reasonably possible that the amount of a loss, when material, will exceed the recorded provision.

In addition to the above, the Company is involved in other legal matters. However, such matters are subject to many uncertainties and outcomes are not predictable with assurance. The Company is unable to estimate a loss or a range of reasonably possible losses with respect to such matters. There can be no assurances as to whether the Company will become subject to significant additional claims and liabilities with respect to ongoing or future proceedings. If actual liabilities significantly exceed the estimates made, the Company's consolidated financial position, results of operations or cash flows could be materially adversely affected. Legal expenses relating to legal matters are expensed as incurred.

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### Restructuring Charges

In the first quarter of fiscal year 2017, the Company offered an enhanced retirement program to its qualifying employees and implemented a workforce reduction (collectively, the "2017 Restructuring Plan"), primarily in its Oncology Systems and VPT segments, to improve operational performance. The Company did not incur any restructuring charges during the three and nine months ended June 29, 2018, respectively, and incurred \$3.1 million and \$9.4 million in restructuring charges during the three and nine months ended June 30, 2017, respectively. As of June 29, 2018, the Company completed this plan.

The following table provides a summary of changes in the restructuring liability related to the Company's restructuring plans:

(In millions)	September 29, 2017	Restructuring Charges	Cash Payments	June 29, 2018
2017 Restructuring Plan	\$ 3.9	\$	—\$ (3.9 )	\$ —
Total	\$ 3.9	\$	—\$ (3.9 )	\$ —

The restructuring charges are included in selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings.

### 11. RETIREMENT PLANS

The Company sponsors five defined benefit pension plans for regular full-time employees in Germany, Japan, Switzerland and the United Kingdom. The Company also sponsors a post-retirement benefit plan that provides healthcare benefits to certain eligible retirees in the United States.

The components of net defined benefit costs were as follows:

(In millions)	Three Months Ended		Nine Months Ended	
	June 29, 2018	June 30, 2017	June 29, 2018	June 30, 2017
Defined Benefit Plans				
Service cost	\$1.6	\$ 1.7	\$4.9	\$ 5.2
Interest cost	0.8	0.6	2.4	1.8
Expected return on plan assets	(2.0 )	(1.7 )	(6.0 )	(5.2 )
Amortization of prior service cost	(0.1 )	(0.1 )	(0.4 )	(0.2 )
Recognized actuarial loss	0.7	1.1	2.1	3.3
Net periodic benefit cost	\$1.0	\$ 1.6	\$3.0	\$ 4.9

### 12. INCOME TAXES

The Company's effective tax rate was 21.2% and 21.1% for the three months ended June 29, 2018 and June 30, 2017, respectively, and 89.2% and 25.7% for the nine months ended June 29, 2018 and June 30, 2017, respectively. The increase in the Company's effective tax rate for the nine months ended June 29, 2018, compared to the year-ago period, was primarily due to the tax effect of the Tax Cuts and Jobs Act (the "Act"), which was signed into law on December 22, 2017. The Company's effective tax rate for the nine months ended June 30, 2017 was also high due to the impairment of the CPTC loans in December 2016, which were made by one of the Company's Swiss subsidiaries, which has a low tax rate, and a significant portion of the expense associated with the allowance for doubtful accounts recorded in the period being attributable to one of the Company's German subsidiaries which has a full valuation allowance.

The Act was signed into law on December 22, 2017. Among other changes, the Act reduces the U.S. corporate tax rate from 35% to 21%, and imposes a one-time transition tax on the unremitted earnings of the Company's foreign subsidiaries. U.S. GAAP generally requires that the tax effect of a change in tax laws or rates be accounted for in the period of enactment.

The reduction in the U.S. corporate tax rate was effective January 1, 2018. As the Company has a September fiscal year end, the lower corporate tax rate will be phased in, resulting in a U.S. corporate rate of approximately 24.6% for the Company's fiscal year ending September 28, 2018, and 21% for subsequent fiscal years. The reduction in the rate requires the Company to re-

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measure its net deferred tax assets that were originally recorded assuming a future tax benefit at the 35% rate. Because the rate change is phased in, a portion of the tax impact was included in the period of enactment and a portion is included gradually during the year of enactment. During the three and nine months ended June 29, 2018, the Company recorded a provisional tax expense of \$1.6 million and \$41.8 million, respectively, related to re-measuring its net deferred tax assets as a result of the rate reduction.

As part of the transition to a modified territorial system, the Act imposes a one-time transition tax on the unremitted earnings of the Company's foreign subsidiaries. The Company recorded a provisional discrete tax expense related to the one-time transition tax of \$173.1 million during the nine months ended June 29, 2018 and none in the three months ended June 29, 2018. The Company intends to elect to pay this tax over the eight-year period allowed for in the Act. The transition to a modified territorial regime and the one-time transition tax on unremitted earnings has also caused the Company to re-evaluate its intentions with respect to the unremitted earnings of foreign subsidiaries. In the past, the Company did not accrue U.S. taxes on certain undistributed profits of certain foreign subsidiaries because the earnings were considered to be indefinitely reinvested. In light of the changes to the taxation of foreign earnings in the Act, the Company no longer considers the earnings of its foreign subsidiaries to be indefinitely reinvested.

Other provisions of the Act include a new minimum tax on certain foreign earnings (the Global Intangibles Low-taxed Income, or "GILTI"), a new tax on certain payments to foreign related parties (the Base Erosion Anti-avoidance Tax, or "BEAT"), a new incentive for Foreign-derived Intangibles Income ("FDII"), changes to the limitation on the deductibility of certain executive compensation, and new limitations on the deductibility of interest expense.

Generally, these other provisions take effect for the Company in the fiscal year ending September 27, 2019.

On December 22, 2017, the SEC issued Staff Accounting Bulletin No. 118 ("SAB 118"). This guidance allows registrants a "measurement period," not to exceed one year from the date of enactment, to complete their accounting for the tax effects of the Act. SAB 118 further directs that during the measurement period, registrants who are able to make reasonable estimates of the tax effects of the Act should include those amounts in their financial statements as "provisional" amounts. Registrants should reflect adjustments over subsequent periods as they are able to refine their estimates and complete their accounting for the tax effects of the Act. The amounts of the tax effects related to the Act described in the paragraphs above represent the Company's current reasonable estimates and are provisional amounts within the meaning of SAB 118. Also, it is expected that the U.S. Treasury will issue regulations and other guidance on the application of certain provisions of the Act. In subsequent periods, but within the measurement period, the Company will analyze that guidance and other necessary information, including the amount of foreign earnings and profits, pools of foreign tax, and the Company's foreign cash position, to refine its estimates and complete its accounting for the tax effects of the Act.

The Company adopted the FASB guidance related to employee share-based payments in the first quarter of fiscal year 2018. Among other changes, this standard changes the treatment of the tax effect of the excess stock deduction. For a share-based compensation instrument, the excess stock deduction is the difference between the amount of the deduction for taxable income and the amount of expense in the financial statements related to that instrument. Under the prior standard, the tax effect of the excess stock deduction related to share-based compensation was recorded to additional paid-in capital in the equity section on the Condensed Consolidated Balance Sheets. Under the new standard, the tax effect of the excess stock deduction related to share-based compensation is recorded as a discrete item to Taxes on Earnings in the Condensed Consolidated Statements of Earnings. For the three and nine months ended June 29, 2018, the Company recorded a discrete tax benefit of \$0.3 million and \$6.5 million, respectively, related to excess stock deduction activity. The Company expects that the new standard may cause its effective tax rate to be less predictable and more volatile going forward.

The Company's effective income tax rate differs from the U.S. federal statutory rate primarily because the Company's foreign earnings are taxed at rates that are, on average, lower than the U.S. federal rate, and because the Company's domestic earnings are subject to state income taxes. The total amount of unrecognized tax benefits increased by \$5.6 million during the nine months ended June 29, 2018, primarily due to the impact of the Act on the Company's



unrecognized tax benefits. The impact of this increase in tax expense is included in the amount of the provisional discrete expense related to the one-time transition tax above. In addition, the amount of unrecognized tax benefits has increased as a result of positions taken during the current and prior years, and has decreased as the result of the expiration of the statute of limitations in various jurisdictions.

VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
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### 13. STOCKHOLDERS' EQUITY AND NONCONTROLLING INTERESTS

#### Share Repurchase Program

In November 2016, the VMS Board of Directors authorized the repurchase of an additional 8.0 million shares of VMS common stock commencing on January 1, 2017. Share repurchases under the Company's authorizations may be made in open market purchases, in privately negotiated transactions (including accelerated share repurchase ("ASR") programs), or under Rule 10b5-1 share repurchase plans, and may be made from time to time in one or more blocks. All shares that were repurchased under the Company's share repurchase programs have been retired. As of June 29, 2018, approximately 4.1 million shares of VMS common stock remained available for repurchase under the November 2016 authorization.

The Company repurchased shares of VMS common stock under various authorizations during the periods presented as follows:

	Three Months Ended		Nine Months Ended	
(In millions, except per share amounts)	June 29, 2018	June 30, 2017	June 29, 2018	June 30, 2017
Number of shares	0.3	0.5	1.1	3.0
Average repurchase price per share	\$120.59	\$93.45	\$112.25	\$89.68
Total cost	\$39.2	\$46.8	\$131.9	\$269.1

#### Other Comprehensive Earnings

The changes in accumulated other comprehensive loss by component and related tax effects are summarized as follows:

(In millions)	Net Unrealized Gains (Losses) Defined Benefit Pension and Post-Retirement Benefit Plans	Net Unrealized Gains (Losses) Cash Flow Hedging Instruments	Cumulative Translation Adjustment	Accumulated Other Comprehensive Loss
Balance at September 29, 2017	\$ (44.1 )	\$ —	\$ (24.7 )	\$ (68.8 )
Other comprehensive earnings (loss) before reclassifications	—	(0.9 )	(3.0 )	(3.9 )
Amounts reclassified out of other comprehensive earnings (loss)	1.3	0.9	—	2.2
Tax expense	(0.2 )	—	—	(0.2 )
Balance at June 29, 2018	\$ (43.0 )	\$ —	\$ (27.7 )	\$ (70.7 )

  

(In millions)	Net Unrealized Gains (Losses) Defined Benefit Pension and Post-Retirement Benefit Plans	Cumulative Translation Adjustment	Accumulated Other Comprehensive Loss
Balance at September 30, 2016	\$ (63.3 )	\$ (37.5 )	\$ (100.8 )
Other comprehensive loss before reclassifications	—	4.5	4.5
Amounts reclassified out of other comprehensive earnings (loss)	2.8	—	2.8

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Tax expense	(0.5	)	—	(0.5	)	
Balance at June 30, 2017	\$ (61.0	)	\$ (33.0	)	\$ (94.0	)

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
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The amounts reclassified out of other comprehensive earnings (loss) into the Condensed Consolidated Statements of Earnings, with line item location, during each period were as follows:

(In millions)	Three Months Ended		Nine Months Ended		Line Item in Statements of Earnings
	June 29, 2018	June 30, 2017	June 29, 2018	June 30, 2017	
Comprehensive Earnings Components					
	Loss Before Taxes	Loss Before Taxes	Loss Before Taxes	Loss Before Taxes	Cost of revenues & Operating expenses
Unrealized loss on defined benefit pension and post-retirement benefit plans	\$(0.4)	\$(0.9 )	\$(1.3)	\$(2.8 )	
Unrealized loss on cash flow hedging instruments	—	—	(0.9 )	—	Revenues
Total amounts reclassified out of other comprehensive earnings (loss)	\$(0.4)	\$(0.9 )	\$(2.2)	\$(2.8 )	

#### Noncontrolling Interests

In connection with the Distribution of Varex in January 2017, the Company's redeemable noncontrolling interests relating to MeVis Medical Solutions AG ("MeVis") were transferred to Varex.

Changes in noncontrolling interests and redeemable noncontrolling interests relating to MeVis and other subsidiaries of the Company were as follows:

(In millions)	Nine Months Ended		
	June 29, 2018	June 30, 2017	June 30, 2017
Beginning of Period	\$4.3	\$3.7	\$10.3
Net earnings attributable to noncontrolling interests	—	0.6	0.1
Transfer of redeemable noncontrolling interests in MeVis to Varex	—	—	(10.3 )
Other	—	—	(0.1 )
End of Period	\$4.3	\$4.3	\$ —

#### 14. EMPLOYEE STOCK PLANS

The table below summarizes the share-based compensation expense recognized for employee stock awards and employee stock purchase plan shares:

(In millions)	Three Months Ended		Nine Months Ended	
	June 29, 2018	June 30, 2017	June 29, 2018	June 30, 2017
Cost of revenues - Product	\$0.8	\$0.7	\$2.3	\$2.3
Cost of revenues - Service	1.1	1.0	3.1	3.1
Research and development	1.2	1.3	3.6	3.9
Selling, general and administrative	10.2	6.1	25.5	21.4
Total share-based compensation expense	\$13.3	\$9.1	\$34.5	\$30.7
Income tax benefit for share-based compensation	\$(3.0 )	\$(2.7 )	\$(7.7 )	\$(9.1 )

The Company adopted new accounting guidance in the first quarter of 2018 where it elected to change its accounting policy to account for forfeitures as they occur rather than estimating expected forfeitures. Share-based compensation expense for the three and nine months ended June 30, 2017 was recorded net of estimated forfeitures. See Note 1,

"Summary of Significant Accounting Policies" for further information.

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VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
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The fair value of options granted was estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions:

	Three Months		Nine Months	
	Ended		Ended	
	June 29,	June 30,	June 29,	June 30,
	2018	2017	2018	2017
Employee Stock Option Plans				
Expected term (in years)	3.85	3.99	3.83	3.99
Risk-free interest rate	2.8	% 1.6	% 2.2	% 1.7
Expected volatility	21.0	% 17.6	% 19.0	% 21.3
Expected dividend	—	% —	% —	% —
Weighted average fair value at grant date	\$24.93	\$15.93	\$20.82	\$16.11

The option component of employee stock purchase plan shares was estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions:

	Three Months		Nine Months	
	Ended		Ended	
	June 29,	June 30,	June 29,	June 30,
	2018	2017	2018	2017
Employee Stock Purchase Plan				
Expected term (in years)	0.50	0.50	0.50	0.50
Risk-free interest rate	2.0	% 1.0	% 1.6	% 0.7
Expected volatility	32.9	% 18.2	% 25.2	% 20.3
Expected dividend	—	% —	% —	% —
Weighted average fair value at grant date	\$28.41	\$18.42	\$24.56	\$18.92

A summary of share-based awards available for grant is as follows:

	Shares
(In millions)	Available for Grant
Balance at September 29, 2017	2.5
Authorized <sup>(1)</sup>	6.0
Granted	(1.8 )
Cancelled or expired	0.4
Balance at June 29, 2018	7.1

<sup>(1)</sup> On February 8, 2018, the Company's stockholders approved its Fifth Amended and Restated 2005 Omnibus Stock Plan ("2005 Plan") to increase the number of shares authorized for issuance by 6.0 million shares.

For purposes of the total number of shares available for grant under the 2005 Plan, any shares subject to awards of stock options and stock appreciation rights are counted against the share reserve limit as one share for every one share subject to the award. Awards other than stock options and stock appreciation rights are counted against the share reserve limit as 2.6 shares for every one share awarded on or after February 9, 2012. The shares reserve limit is further adjusted to reflect a maximum payout that could be issued for each performance grant. The maximum payouts that could be issued for each performance grant are 2.0 shares for fiscal year 2018 grants, 1.75 shares for fiscal years 2017 and 2016 grants, and 2.0 shares for fiscal year 2015 grants. All awards may be subject to restrictions on transferability and continued employment as determined by the Compensation and Management Development Committee.

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Activity under the Company's employee stock plans related to stock options is presented below:

(In millions, except per share amounts)	Options Outstanding			Aggregate Intrinsic Value <sup>(1)</sup>
	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Term (in years)	
Balance at September 29, 2017	2.3	\$ 74.08		
Granted	0.6	111.57		
Cancelled or expired <sup>(2)</sup>	—	81.43		
Exercised	(0.6)	70.97		
Balance at June 29, 2018	2.3	\$ 85.33	4.9	\$ 66.4
Exercisable at June 29, 2018	1.2	\$ 74.00	3.9	\$ 46.0

The aggregate intrinsic value represents the total pre-tax intrinsic value, which is computed based on the difference between the exercise price and the closing price of VMS common stock of \$113.72 as of June 29, 2018, the last <sup>(1)</sup> trading date of the third quarter of fiscal year 2018, and which represents the amount that would have been received by the option holders had all option holders exercised their options and sold the shares received upon exercise as of that date.

<sup>(2)</sup> The cancelled and expired shares were not material for disclosure.

As of June 29, 2018, there was \$15.8 million of total unrecognized compensation expense related to stock options granted under the Company's employee stock plans. This unrecognized compensation expense is expected to be recognized over a weighted average period of 2.1 years.

The activity for restricted stock, restricted stock units, deferred stock units and performance units is summarized as follows:

(In millions, except per share amounts)	Number of Shares	Weighted
		Average Grant-Date Fair Value
Balance at September 29, 2017	0.9	\$ 75.37
Granted	0.3	111.93
Vested	(0.3 )	76.61
Cancelled or expired	(0.1 )	86.13
Balance at June 29, 2018	0.8	\$ 88.79

As of June 29, 2018, unrecognized compensation expense totaling \$40.2 million was related to awards of restricted stock units, deferred stock units and performance units granted under the Company's employee stock plans. This unrecognized share-based compensation expense is expected to be recognized over a weighted average period of 1.9 years.

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## 15. EARNINGS PER SHARE

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

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

	Three Months Ended		Nine Months Ended	
(In millions, except per share amounts)	June 29, 2018	June 30, 2017	June 29, 2018	June 30, 2017
Net earnings from continuing operations	\$72.5	\$ 69.9	\$33.5	\$147.4
Less: Net (loss) earnings from continuing operations attributable to noncontrolling interests	(0.1 )	0.2	—	0.6
Net earnings from continuing operations attributable to Varian	\$72.6	\$ 69.7	\$33.5	\$146.8
Net loss from discontinued operations	\$—	\$ —	\$—	\$(6.8 )
Less: Net earnings from discontinued operations attributable to noncontrolling interests	—	—	—	0.1
Net loss from discontinued operations attributable to Varian	\$—	\$ —	\$—	\$(6.9 )
Net earnings attributable to Varian	\$72.6	\$ 69.7	\$33.5	\$139.9
Weighted average shares outstanding - basic	91.5	91.7	91.6	92.7
Dilutive effect of potential common shares	1.0	0.7	1.0	0.8
Weighted average shares outstanding - diluted	92.5	92.4	92.6	93.5
Net earnings (loss) per share attributable to Varian - basic				
Continuing operations	\$0.79	\$ 0.76	\$0.37	\$1.58
Discontinued operations	—	—	—	(0.08 )
Net earnings per share - basic	\$0.79	\$ 0.76	\$0.37	\$1.50
Net earnings (loss) per share attributable to Varian - diluted				
Continuing operations	\$0.79	\$ 0.75	\$0.36	\$1.57
Discontinued operations	—	—	—	(0.07 )
Net earnings per share - diluted	\$0.79	\$ 0.75	\$0.36	\$1.50
Anti-dilutive employee share-based awards, excluded	0.7	0.1	0.7	0.5

The Company excludes potentially dilutive common shares (consisting of shares underlying stock options and the employee stock purchase plan) from the computation of diluted weighted average shares outstanding if the per share value, either the exercise price of the awards or the sum of (a) the exercise price of the awards and (b) the amount of the compensation cost attributed to future services and not yet recognized and (c) the amount of tax benefit or shortfall that would be recorded in additional paid-in capital when the award becomes deductible, is greater than the average market price of the shares, because the inclusion of the shares underlying these stock awards would be anti-dilutive to earnings per share.



## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

## 16. VPT LOANS AND INVESTMENT

In limited cases, the Company participates, along with other investors and at market terms, in the financing of proton therapy centers. Over time, the Company has divested some of its investments, including investments in CPTC, NYPC and DRTC.

The following table lists the Company's outstanding loans and investments, including accrued interest, and commitments for funding development, construction and operations of various proton therapy centers:

(In millions)	June 29, 2018		September 29, 2017	
	Balance	Commitment	Balance	Commitment
Notes receivable and secured debt:				
MPTC loans <sup>(1)</sup>	\$47.9	\$ —	\$67.4	\$ —
RPTC senior secured debt <sup>(2)</sup>	25.1	—	25.4	—
NYPC loan <sup>(3)</sup>	27.1	—	24.6	—
PI loan <sup>(3)</sup>	1.6	—	3.1	—
CPTC DIP loan <sup>(3)</sup>	—	—	5.1	2.2
	\$101.7	\$ —	\$125.6	\$ 2.2
Available-for-sale Securities:				
APTC securities <sup>(2)</sup>	\$6.3	\$ —	\$—	\$ —
GPTC securities <sup>(3)</sup>	4.6	11.8	4.4	11.8
Original CPTC loans <sup>(3)</sup>	—	—	47.4	—
DRTC securities <sup>(3)</sup>	—	—	8.3	—
	\$10.9	\$ 11.8	\$60.1	\$ 11.8
CPTC Loans and Investment:				
Short-term revolving loan <sup>(2)</sup>	\$3.1	\$ 4.1	\$—	\$ —
Term loan <sup>(3)</sup>	44.0	—	—	—
Equity investment in CPTC <sup>(3)</sup>	5.2	—	—	—
	\$52.3	\$ 4.1	\$—	\$ —

Includes \$22.9 million and \$42.4 million in other assets at June 29, 2018 and September 29, 2017, respectively, <sup>(1)</sup> and \$25.0 million in prepaid and other current assets at June 29, 2018 and other assets at September 29, 2017 on the Company's Condensed Consolidated Balance Sheets.

<sup>(2)</sup> Included in prepaid and other current assets on the Company's Condensed Consolidated Balance Sheets.

<sup>(3)</sup> Included in other assets on the Company's Condensed Consolidated Balance Sheets.

## Alabama Proton Therapy Center ("APTC") Securities

In December 2017, the Company purchased \$6.0 million in Subordinate Revenue Bonds from the Public Finance Authority, which financed the APTC. The Subordinate Revenue Bonds carry an interest rate of 8.5% and pay interest semi-annually. The Company is scheduled, based upon the terms, to start receiving annual principal payments on the Subordinate Revenue Bonds beginning on November 1, 2022. The Subordinate Revenue Bonds will mature on October 1, 2047.

## Rinecker Proton Therapy Center ("RPTC") Senior Secured Debt

In July 2017, the Company purchased the outstanding senior secured debt related to the RPTC in Munich, Germany for 21.5 million Euros or \$24.5 million. By purchasing the senior secured debt, the Company has a right to 89 million Euros in claims against all of RPTC's assets. In September 2017, the management of RPTC filed for bankruptcy in Germany. In January 2018, the final insolvency proceedings commenced, and the Company expects the insolvency proceedings to be finalized within the next twelve months. Upon finalization of bankruptcy proceedings, the Company believes it is probable it will recover the outstanding senior secured debt balance and trade accounts receivable, net.



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At both June 29, 2018, and September 29, 2017, the Company had \$4.5 million, in trade receivables, net for RPTC, which does not include any unbilled receivables.

Georgia Proton Treatment Center ("GPTC") Security

In July 2017, the Company committed to purchase up to \$16.1 million in Senior Capital Appreciation Bonds ("Senior Bonds") from the Atlanta Development Authority, which financed the GPTC. In July 2017, the Company purchased \$4.3 million of the Senior Bonds that carry an interest rate of 8.0% per annum with interest accruing up to the principal amount of \$6.6 million until January 1, 2023 and then will pay cash interest semi-annually. The Company purchased the remaining \$11.8 million of the commitment in July 2018 with similar terms to the first tranche. The Company is scheduled, based upon the original terms, to start receiving annual principal payments on the Senior Bonds beginning on January 1, 2024. The Senior Bonds will mature on January 1, 2028.

In addition to the outstanding loan, the Company had \$12.1 million as of June 29, 2018 in trade and unbilled receivables, which included \$11.9 million in unbilled receivables from GPTC. The Company did not have any trade and unbilled receivables as of September 29, 2017 from GPTC.

Delray Radiation Therapy Center ("DRTC") Securities and Loan

In April 2017, the Company purchased \$8.0 million in Subordinate Bonds from the Public Finance Authority, which financed the DRTC. The Subordinate Bonds carried an interest rate of 8.5% and paid interest semi-annually. In January 2018, the Company sold all of its Subordinate Bonds for \$8.5 million, which included accrued interest.

New York Proton Center ("NYPC") Loan

In July 2015, the Company committed to loan up to \$91.5 million to MM Proton I, LLC in connection with a purchase agreement to supply a proton system to equip the NYPC. In June 2016, the Company assigned \$73.0 million of this loan to Deutsche Bank AG. The remaining balance is comprised of an \$18.5 million "Subordinate Loan" with a six-and-a-half-year term at up to 13.5% interest. The principal balance and accrued interest on the Subordinate Loan are due in full at maturity in January 2022.

In addition to the outstanding loan, as of June 29, 2018, the Company had \$19.6 million of unbilled receivables and as of September 29, 2017, the Company had \$13.3 million in trade and unbilled receivables, which included \$1.3 million in unbilled receivables from NYPC.

Maryland Proton Treatment Center ("MPTC") Loans

In May 2015, the Company committed to loan up to \$35.0 million to MPTC. The Company completed its funding requirements per the loan agreement in the first quarter of fiscal year 2017. The Company's lending is in the form of a subordinated loan that is due, with accrued interest, in three annual payments from 2020 to 2022. The interest on the loan accrues at 12.0%. In the three and nine months ended fiscal year 2018, the Company recorded impairment charges of \$11.0 million and \$22.1 million, respectively, on its MPTC subordinated loan, which included accrued interest, due to the expected difference in value between the loan currently held by the Company and the value of the security to be issued to the Company in exchange as part of the refinancing expected in the fourth quarter of fiscal year 2018.

In addition, the Company had previously entered into an agreement with MPTC to supply it with a proton system, which included a deferral of up to \$25.0 million of equipment payments when triggered by achievement of delivery milestones under the contract. As of June 29, 2018, the Company has recorded \$25.0 million as a notes receivable related to this deferred payment arrangement. The notes receivable is due September 30, 2018.

As of June 29, 2018, and September 29, 2017, the Company had zero net trade and unbilled receivables from MPTC.

Variable Interest Entities

The Company has determined that MM Proton I, LLC, MPTC, and RPTC are variable interest entities and that the Company holds a significant variable interest of each of the entities through its participation in the loan facilities and its agreements to supply and service the proton therapy equipment. The Company has concluded that it is not the primary beneficiary of any of these entities. The Company has no voting rights, has no approval authority or veto rights for these centers' budget, and does



## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

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not have the power to direct patient recruitment, clinical operations and management of these Centers, which the Company believes are the matters that most significantly affect their economic performance. The Company's exposure to loss as a result of its involvement with MM Proton I, LLC, MPTC, and RPTC is limited to the carrying amounts of the above-mentioned assets on its Condensed Consolidated Balance Sheets.

**California Proton Therapy Center ("CPTC") Loans and Investment**

Between September 2011 and November 2015, the Company, ORIX and J.P. Morgan ("the Lenders") committed to loan up to \$185.0 million (the "Original CPTC Loans"), of which the Company's commitment was \$84.7 million, to fund the development, construction, initial operations, and working capital needs of the Scripps Proton Therapy Center in San Diego, California. ORIX is the loan agent. In November 2015, the Lenders and California Proton Treatment Center ("Original CPTC") entered into a forbearance agreement whereby the Lenders agreed not to enforce their rights to principal and interest payments until April 2017, subject to Original CPTC maintaining certain covenants and achieving certain targets, with additional extensions through September 2017 based on hitting additional targets largely around patient volume and cash flow.

As of December 30, 2016, even though patient volumes continued to increase, Original CPTC was not in compliance with one of the patient volume covenants in the forbearance agreement, which would allow the Lenders to cease funding and terminate the forbearance agreement. In January 2017, the Company was informed of actions taken by Original CPTC and the loan agent, including Original CPTC obtaining shareholder consents for voluntary bankruptcy filing and the loan agent deciding that no additional funding would be available outside of a bankruptcy process. As a result of this information and the Company's analysis that these actions would likely lead to insolvency or bankruptcy proceedings of Original CPTC, the Company determined that it was appropriate to record a \$38.3 million impairment, as determined by the discounted cash flow model using a single best estimate methodology, of its Original CPTC Loans on the Condensed Consolidated Statements of Earnings in the first quarter of fiscal year 2017. As a result of this impairment, the Original CPTC Loans were written down to their estimated fair value of \$60.0 million and reclassified from short-term investments to other assets on the Company's Condensed Consolidated Balance Sheet because the Company did not expect to collect or sell all or a portion of these loans in the next twelve months.

In March 2017, Original CPTC filed for bankruptcy and concurrently entered into a Debtor-in-Possession facility (the "DIP Facility") with the Lenders for up to \$16.0 million of additional financing during the bankruptcy process. The Company's pro-rata share of the DIP Facility was \$7.3 million. In December 2017, the Company completed its funding commitment under the DIP Facility. The DIP Facility carried an interest rate at the London Interbank Offer Rate ("LIBOR") plus 9.0% per annum and had a senior secured position ahead of the Original CPTC Loans.

Between April 2017 and August 2017, the Company did not become aware of any new information that warranted an impairment assessment. In September 2017, the Lenders and Scripps signed a Transition Agreement to transition the operations of the center from Scripps to Proton Doctors Professional Corporation ("Practice"). Based on the terms of the Transition Agreement, a slower projected growth in patient volume, an increase in additional projected capital needs and the Company's analysis, the Company determined that an additional \$13.1 million impairment charge was deemed appropriate on its Original CPTC Loans which was recorded on the Consolidated Statements of Earnings in the fourth quarter of fiscal year 2017.

Pursuant to an order of the Bankruptcy Court, Original CPTC conducted an auction of the Scripps Proton Therapy Center. On December 6, 2017 ("Closing Date"), the Bankruptcy Court approved the sale of Scripps Proton Therapy Center to California Proton Therapy Center, LLC ("CPTC"), an entity owned by the Lenders. The Lenders purchased all assets and assumed \$112.0 million of Original CPTC's outstanding liabilities. On December 13, 2017, the Bankruptcy Court dismissed the bankruptcy filing of Original CPTC.

On the Closing Date, the Lenders entered into a Credit Agreement with Original CPTC of which the terms of the Original CPTC Loans, DIP Facility and accrued interest (collectively "Former Loans") have been modified. In addition to the partially satisfied Original CPTC Loans reinstated by the Bankruptcy Court, the Company received a 47.08% equity ownership in CPTC. Original CPTC has assigned all its Former Loans to CPTC at an amount of \$112.0

million, the partially satisfied loan balance. Per the terms of the Credit Agreement, the Company's portion of the \$112.0 million is \$53.5 million; the remainder is allocated between ORIX and J.P. Morgan. The \$53.5 million is composed of four Tranches: Tranche A of \$2.0 million, Tranche B of \$7.2 million, Tranche C of \$15.6 million, and Tranche D of \$28.7 million (collectively the "Term Loan"). The maturity date of the Term Loan is three years from the Closing Date. The Term Loan is secured by the assets of CPTC.

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(Unaudited)

In addition, the Lenders have committed to lend up to \$15.0 million in a Revolving Loan with a maturity date of one year from the Closing Date. The Company's share of the funding commitment from the Revolving Loan is \$7.2 million, and as of June 29, 2018, the Company has funded \$3.1 million.

All of the Tranches accrue paid-in-kind interest at 7.5% per annum, except the Tranche B and Revolving Loan which accrue paid-in-kind interest at 10% per annum. The seniority of these loans is as follows: Revolving Loan, Tranche A, Tranche B, Tranche C and Tranche D. If CPTC is in default, the interest rate of the Tranche A, C and D will increase to 9.5% and the interest rate on the Tranche B and the Revolving Loan will increase to 12.0%.

Considering Original CPTC's financial difficulties, the modification of the original terms of the Former Loans, and the Lenders agreement to grant a concession on the Original CPTC Loans, the Company classified the transaction above as a troubled debt restructuring ("TDR"). The Company does not have any unamortized fees from the Former Loans and any prepayment penalties. As a result, the cost basis and fair value of the Company's outstanding Term Loan as of June 29, 2018 is \$53.5 million, which approximates the carrying value of the Former Loans prior to the TDR.

The Company, using a discounted cash flow approach, determined that the fair value of CPTC's equity as of Closing Date is \$20.1 million. The Company's 47.08% ownership percentage amounts to a \$9.5 million equity interest in CPTC. Since the common stock received was in addition to a loan receivable partially satisfied through the bankruptcy proceedings, in accordance with the TDR accounting guidance, the Company recorded the equity interest at fair value and as an offset to the reinstated loan balance. The equity investment in CPTC is accounted for under the equity method of accounting, and the Company accounts for its equity method share of the income or loss of CPTC on a quarter lag basis. The Company recorded a loss from its equity investment in CPTC of \$3.4 million and \$4.3 million in the three and nine months ended June 29, 2018, respectively, in selling, general and administrative expenses on the Condensed Consolidated Statements of Earnings.

Per the terms of the Former Loans, as of September 29, 2017, ORIX had the option to purchase the Company's share of the Original CPTC Loans at par, and therefore they were accounted for as available-for-sale securities. Per the terms of the new agreement, ORIX no longer has the option to purchase the Company's share of the Term Loan at par. As a result, the Term Loan no longer qualified for available-for-sale classification as of December 29, 2017.

Further, the Company has determined that CPTC is a variable interest entity because of the Company's participation in the loan facilities, equity ownership and its operations and maintenance agreement. The Company has one board seat out of five, has no special approval authority or veto rights for CPTC's budget, and does not have the power to direct patient recruitment, clinical operations and management of CPTC, which the Company believes are the matters that most significantly affect their economic performance. Therefore, the Company does not have majority voting rights and no power to direct activities at CPTC as a result it is not the primary beneficiary of CPTC.

#### 17. SEGMENT INFORMATION

The Company has two reportable operating segments: Oncology Systems and VPT. The operating segments were determined based on how the Company's Chief Executive Officer, its Chief Operating Decision Maker ("CODM"), views and evaluates the Company's operations. The CODM allocates resources to and evaluates the financial performance of each operating segment primarily based on operating earnings.

##### Description of Segments

The Oncology Systems segment designs, manufactures, sells and services hardware and software products for treating cancer with conventional radiation therapy, and advanced treatments such as fixed field intensity-modulated radiation therapy ("IMRT"), image-guided radiation therapy ("IGRT"), VMAT, stereotactic radiosurgery ("SRS"), stereotactic body radiotherapy ("SBRT") and brachytherapy. Products include linear accelerators, brachytherapy afterloaders, treatment simulation and verification equipment and accessories; as well as information management, treatment planning and image processing, clinical knowledge exchange, patient care management, decision-making support and practice management software. Oncology Systems' products enable radiation oncology departments in hospitals and clinics to perform conventional radiotherapy treatments and offer advanced treatments such as IMRT, IGRT, VMAT, SRS and SBRT, as well as to treat patients using brachytherapy techniques, which involve temporarily implanting radioactive

sources. The Company's Oncology Systems products are also used by neurosurgeons to perform stereotactic radiosurgery. Oncology Systems' customers worldwide include university research and community hospitals, private and governmental institutions, healthcare agencies, physicians' offices and cancer care clinics.



VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES  
 NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)  
 (Unaudited)

The VPT segment develops, designs, manufactures, sells and services products and systems for delivering proton therapy, a form of external beam radiotherapy using proton beams for the treatment of cancer.

Accordingly, the following information is provided for purposes of achieving an understanding of operations, but may not be indicative of the financial results of the reported segments were they independent organizations. In addition, comparisons of the Company's operations to similar operations of other companies may not be meaningful.

The Company allocates corporate costs to its operating segments based on the relative revenues of Oncology Systems and VPT. The Company allocates these costs excluding certain corporate related costs, transactions or adjustments that the Company's CODM considers to be non-operational, such as restructuring and impairment charges, significant litigation charges or benefits and legal costs, acquisition-related expenses and benefits. Although the Company excludes these amounts from segment operating earnings and loss, they are included in the consolidated operating earnings and included in the reconciliation below.

The following table summarizes select operating results information for each reportable segment:

(In millions)	Three Months Ended		Nine Months Ended	
	June 29, 2018	June 30, 2017	June 29, 2018	June 30, 2017
	Revenues			
Oncology Systems	\$667.2	\$564.4	\$2,014.6	\$1,767.5
Varian Particle Therapy	41.9	68.4	102.9	130.0
Total Company	\$709.1	\$632.8	\$2,117.5	\$1,897.5
Operating Earnings				
Oncology Systems	\$125.6	\$104.3	\$406.9	\$343.3
Varian Particle Therapy	(10.1 )	(12.4 )	(42.8 )	(82.5 )
Total reportable segments	115.5	91.9	364.1	260.8
Unallocated corporate	(24.0 )	(3.4 )	(56.9 )	(64.8 )
Total Company	\$91.5	\$88.5	\$307.2	\$196.0

## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

## Disaggregation of Revenues

The Company disaggregates its revenues from contracts by major product categories and by geographic region for each of its reportable operating segments, as the Company believes this best depicts how the nature, amount, timing and uncertainty of revenues and cash flows are affected by economic factors. See details in the tables below.

Total Revenues by product type	Three Months Ended			Nine Months Ended		
	June 29, 2018			June 29, 2018		
(In millions)	Oncology	Varian	Total	Oncology	Varian	Total
	Systems	Particle Therapy		Systems	Particle Therapy	
Hardware	\$276.5	\$ 38.1	\$314.6	\$881.2	\$ 95.5	\$976.7
Software <sup>(1)</sup>	125.1	—	125.1	366.9	—	366.9
Service	265.6	3.8	269.4	766.5	7.4	773.9
Total Revenues	\$667.2	\$ 41.9	\$709.1	\$2,014.6	\$ 102.9	\$2,117.5

(1) Includes software support agreements that are recorded in revenues from service in the Condensed Consolidated Statements of Earnings.

Total Revenues by product type	Three Months Ended			Nine Months Ended		
	June 30, 2017			June 30, 2017		
(In millions)	Oncology	Varian	Total	Oncology	Varian	Total
	Systems	Particle Therapy		Systems	Particle Therapy	
Hardware	\$214.9	\$ 66.5	\$281.4	\$736.0	\$ 123.4	\$859.4
Software <sup>(1)</sup>	110.4	—	110.4	342.8	—	342.8
Service	239.1	1.9	241.0	688.7	6.6	695.3
Total Revenues	\$564.4	\$ 68.4	\$632.8	\$1,767.5	\$ 130.0	\$1,897.5

(1) Includes software support agreements that are recorded in revenues from service in the Condensed Consolidated Statements of Earnings.

Total Revenues by geographical region	Three Months Ended			Nine Months Ended		
	June 29, 2018			June 29, 2018		
(In millions)	Oncology	Varian	Total	Oncology	Varian	Total
	Systems	Particle Therapy		Systems	Particle Therapy	
Americas	\$323.2	\$ 19.4	\$342.6	\$981.8	\$ 57.7	\$1,039.5
EMEA	208.5	21.2	229.7	633.2	43.3	676.5
APAC	135.5	1.3	136.8	399.6	1.9	401.5
Total Revenues	\$667.2	\$ 41.9	\$709.1	\$2,014.6	\$ 102.9	\$2,117.5
North America	\$298.7	\$ 19.4	\$318.1	\$924.6	\$ 57.7	\$982.3
International	368.5	22.5	391.0	1,090.0	45.2	1,135.2
Total Revenues	\$667.2	\$ 41.9	\$709.1	\$2,014.6	\$ 102.9	\$2,117.5

## VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

(Unaudited)

Total Revenues by geographical region (In millions)	Three Months Ended June 30, 2017			Nine Months Ended June 30, 2017		
	Oncology Systems	Varian Particle Therapy	Total	Oncology Systems	Varian Particle Therapy	Total
Americas	\$286.9	\$ 49.4	\$336.3	\$909.7	\$ 66.4	\$976.1
EMEA	157.6	11.9	169.5	494.1	44.7	538.8
APAC	119.9	7.1	127.0	363.7	18.9	382.6
Total Revenues	\$564.4	\$ 68.4	\$632.8	\$1,767.5	\$ 130.0	\$1,897.5
North America	\$274.7	\$ 49.4	\$324.1	\$859.4	\$ 66.4	\$925.8
International	289.7	19.0	308.7	908.1	63.6	971.7
Total Revenues	\$564.4	\$ 68.4	\$632.8	\$1,767.5	\$ 130.0	\$1,897.5

Timing of revenue recognition (In millions)	Three Months Ended June 29, 2018			Nine Months Ended June 29, 2018		
	Products transferred at a point in time	Services transferred over time	Total	Products transferred at a point in time	Services transferred over time	Total
Oncology Systems	\$326.9	\$ 340.3	\$667.2	\$1,028.9	\$ 985.7	\$2,014.6
Varian Particle Therapy	—	41.9	41.9	—	102.9	102.9
Total Revenues	\$326.9	\$ 382.2	\$709.1	\$1,028.9	\$ 1,088.6	\$2,117.5

Timing of revenue recognition (In millions)	Three Months Ended June 30, 2017			Nine Months Ended June 30, 2017		
	Products Transferred at a Point in Time	Products and Services Transferred Over Time	Total	Products Transferred at a Point in Time	Products and Services Transferred Over Time	Total
Oncology Systems	\$253.7	\$ 310.7	\$564.4	\$870.9	\$ 896.6	\$1,767.5
Varian Particle Therapy	—	68.4	68.4	—	130.0	130.0
Total Revenues	\$253.7	\$ 379.1	\$632.8	\$870.9	\$ 1,026.6	\$1,897.5

## 18. SUBSEQUENT EVENTS

Acquisition. On July 31, 2018, the Company acquired a business focused on surface guided radiation therapy solutions, for approximately \$50 million plus an earnout. The initial purchase accounting for this transaction was not yet complete at the filing of this Report.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and  
Stockholders of Varian Medical Systems, Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Varian Medical Systems, Inc. and its subsidiaries as of June 29, 2018, and the related condensed consolidated statements of earnings and of comprehensive earnings for the three-month and nine-month periods ended June 29, 2018 and June 30, 2017 and the condensed consolidated statements of cash flows for the nine-month periods ended June 29, 2018 and June 30, 2017. These interim financial statements are the responsibility of the Company's management.

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

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

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of September 29, 2017, and the related consolidated statements of earnings and of comprehensive earnings, of equity, and of cash flows for the year then ended (not presented herein), and in our report dated November 27, 2017, we expressed an unqualified opinion on those consolidated financial statements. As discussed in Note 1 to the accompanying condensed consolidated interim financial statements, the Company adopted Accounting Standard Codification 606, Revenue from contracts with customers. The accompanying September 29, 2017 condensed consolidated balance sheet reflects this change.

/s/ PRICEWATERHOUSECOOPERS LLP  
PricewaterhouseCoopers LLP  
San Jose, California  
August 7, 2018

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

### Forward-Looking Statements

This Quarterly Report on Form 10-Q contains "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995, which provides a "safe harbor" for statements about future events, products and future financial performance that are based on the beliefs of, estimates made by, and information currently available to the management of Varian Medical Systems, Inc. ("VMS") and its subsidiaries (collectively "we," "our" or the "Company"). The outcome of the events described in these forward-looking statements is subject to risks and uncertainties. Actual results and the outcome or timing of certain events may differ significantly from those projected in these forward-looking statements or management's current expectations due to the factors cited in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A"), the Risk Factors listed under Part II, Item 1A of this Quarterly Report on Form 10-Q, and other factors described from time to time in our other filings with the Securities and Exchange Commission ("SEC"), or other reasons. For this purpose, statements concerning: growth strategies; industry or market segment outlook; market acceptance of or transition to new products or technology such as fixed field intensity-modulated radiation therapy, image-guided radiation therapy, stereotactic radiosurgery, volumetric modulated arc therapy, brachytherapy, software, treatment techniques, and proton therapy; growth drivers; future orders, revenues, operating expenses, tax rate, cash flows, backlog, earnings growth or other financial results; the estimated charges relating to the anticipated refinancing of the Maryland Proton Treatment Center loan; potential tariffs or a global trade war; and any statements using the terms "believe," "expect," "anticipate," "can," "should," "would," "could," "estimate," "may," "intended," "potential," and "possible" or similar statements are forward-looking statements that involve risks and uncertainties that could cause our actual results and the outcome and timing of certain events to differ materially from those projected or management's current expectations. By making forward-looking statements, we have not assumed any obligation to, and you should not expect us to, update or revise those statements because of new information, future events or otherwise.

### Overview

We, Varian Medical Systems, Inc., are a Delaware corporation originally incorporated in 1948 as Varian Associates, Inc. We are the world's leading manufacturer of medical devices and software for treating cancer and other medical conditions with radiotherapy, stereotactic radiosurgery, stereotactic body radiotherapy, brachytherapy and proton therapy. Our mission is to combine the ingenuity of people with the power of data and technology to achieve new victories against cancer. To meet this challenge, we offer comprehensive solutions for fighting cancer.

We have two reportable operating segments: Oncology Systems and Varian Particle Therapy ("VPT"). The operating segments were determined based on how our Chief Executive Officer, who is our Chief Operating Decision Maker ("CODM"), views and evaluates our operations. The CODM allocates resources to and evaluates the financial performance of each operating segment primarily based on operating earnings.

**Long-term growth and value creation strategy.** We are focused on cancer care solutions and well-positioned to positively influence more and more patients globally every day by bringing smarter and simpler solutions to healthcare providers. Our long-term growth and value creation strategy is to transform our company from the global leader in radiation therapy to become the global leader in multidisciplinary, integrated cancer care solutions. We intend to leverage our deep customer relationships, human-centered design, scale and financial strength to selectively broaden our capabilities to capitalize on industry trends. To achieve these long-term objectives, we are focused on driving growth through strengthening our leadership in radiation therapy, extending our global footprint and expanding into other addressable markets.

**Adoption of ASC 606.** At the beginning of our fiscal year 2018, we early adopted the new revenue recognition Accounting Standard Codification 606 "Revenues from Contracts with Customers" ("ASC 606") and used the full retrospective method. All financial statements and disclosures have been recast to comply with ASC 606. See Note 1, "Summary of Significant Accounting Policies" of the Notes to the condensed consolidated financial statements, for additional information.

**Change in Gross Orders Policy.** In the first quarter of fiscal year 2018, we decided to retroactively change our policy on how we record services gross orders. Under the new policy, services gross orders do not include changes in deferred services revenue. We made the change to more accurately reflect the operational performance of the services

business and to eliminate variations in orders reporting due to the timing of services billings. This policy change also impacts backlog, which no longer reflects the deferred revenue related to purchasable services. These changes only impact the Oncology Systems gross orders. All prior periods' gross orders and backlog have been recast to reflect this policy change.

Distribution. On January 28, 2017 (the "Distribution Date"), we completed the separation and distribution (the "Distribution") of Varex Imaging Corporation ("Varex"), our former Imaging Components business segment. The historical financial position and results of operations of the Imaging Components business and costs relating to the Distribution are reported in the condensed consolidated financial statements as discontinued operations for all the periods presented. Unless otherwise noted, the financial information herein has been recast to reflect the effect of the Distribution. The Condensed Consolidated Statements of Comprehensive Earnings and the Statements of Cash Flows have not been recast to reflect the effect of the Distribution. See Note 2, "Discontinued Operations" of the Notes to the condensed consolidated financial statements, for additional information.

Sirtex Medical Limited. On January 30, 2018, we signed an agreement to acquire Sirtex Medical Limited ("Sirtex"), an Australian company that is listed on the Australian Securities Exchange, for A\$28 per share or approximately A\$1.6 billion. On May 4, 2018, Sirtex received an unsolicited non-binding, indicative and conditional proposal from CDH Investments ("CDH"), a China-based alternative asset manager, for the acquisition of all of the issued shares in Sirtex for A\$33.60 per share. On June 14, 2018, we received notification from Sirtex that it had accepted the proposal from CDH and consequently, Sirtex terminated its agreement with us and we received a net \$9.0 million breakup fee from Sirtex.

Acquisitions. During the first nine months of fiscal year 2018, we acquired two privately-held software companies and a distributor of radiotherapy equipment, for an aggregate purchase price of \$58.7 million. The purchase price of all three acquisitions primarily consisted of \$22.8 million in finite-lived intangible assets and \$17.9 million in goodwill. We have integrated these three acquisitions into our Oncology Systems reporting unit.

Acquisition-related expenses. During the three and nine months ended June 29, 2018, we incurred acquisition-related expenses of \$12.7 million and \$33.9 million, respectively, which includes losses related to hedging the anticipated Australian dollar purchase price for Sirtex, as well as acquisition costs, partially offset by a net \$9.0 million breakup fee received from Sirtex in connection with the termination of the acquisition.

2018 Revolving Credit Facility. On April 3, 2018, we entered into a credit agreement (the "2018 Credit Agreement") with certain lenders and Bank of America, N.A. ("BofA"), as the administrative agent. The 2018 Credit Agreement provides for a five-year revolving credit facility (the "2018 Revolving Credit Facility") in an aggregate principal amount of up to \$1.8 billion. The 2018 Revolving Credit Facility also includes a \$50.0 million sub-facility for the issuance of letters of credit and permits swing line loans of up to \$25 million. The proceeds of the 2018 Revolving Credit Facility may be used for working capital, capital expenditures, our share repurchases, permitted acquisitions and other corporate purposes, as well as to satisfy the prior outstanding obligation under the 2017 Revolving Credit Facility. As of June 29, 2018, we did not have an outstanding principal balance on our 2018 Revolving Credit Facility. See, Liquidity and Capital Resources, herein for more information.

Tariff Measures. On July 6, 2018, the Trump Administration imposed 25% tariffs on a variety of imports from China, including Varian radiotherapy systems manufactured in China and certain components we import into the U.S. for our manufacturing and service activities. The Administration has also proposed two additional lists of products from China on which to impose tariffs; the first of these proposed lists involves 25% tariffs and the second involves 10% tariffs. We expect our imports into the U.S. to be impacted less by these two proposed tariff lists than by the tariff list that was already imposed.

China has responded to the new and proposed U.S. tariffs by announcing two lists of products from the U.S. that are or, may in the future, be subject to new tariffs upon import to China. One round of Chinese retaliatory tariffs went into effect on July 6, 2018. Our products are not impacted by these tariffs. Our exports to China are, however, impacted by the second Chinese list, which has not taken effect yet. Any tariffs imposed by the United States and China that include Varian technology could increase the cost of our products and adversely impact the competitiveness of our products and our operational results in the future.

In addition to conversations with the Administration, we are participating in the Office of the U.S. Trade Representative (USTR) process to consider product-specific exclusions from these tariffs. While we are uncertain of

the outcome of these exclusion discussions, if we are successful, certain Varian products could be provided retroactive relief from these tariffs to the date of their enactment. In addition, we will continue to evaluate our global supply chain in light of the long-term uncertainty of these tariff measures.

Financial Information. Total revenues increased 12%, gross margin percentage increased 2.2%, the effective tax rate was flat, net earnings from continuing operations increased 4%, and net earnings from continuing operations per diluted share increased 4%, in the three months ended June 29, 2018, compared to the year-ago period.



Gross orders increased 11% in Oncology Systems in the three months ended June 29, 2018, compared to the year-ago period. Our total backlog at June 29, 2018 was 5% higher compared to June 30, 2017.

In order to assist with the assessment of how our underlying businesses performed, we compare the percentage change in revenues and Oncology Systems gross orders from one period to another, excluding the effect of foreign currency fluctuations (i.e., using constant currency exchange rates). To present this information on a constant currency basis, we convert current period revenues and gross orders in currencies other than U.S. Dollars into U.S. Dollars using the comparable prior period's average exchange rate. Percentage changes in revenue and gross orders are not adjusted for constant currency unless indicated.

Currency fluctuations had a \$15.5 million and \$15.4 million favorable impact on total revenues and Oncology Systems gross orders, respectively, for the three months ended June 29, 2018, compared to the year-ago period. We expect that fluctuations of non-U.S. Dollar currencies against the U.S. Dollar may continue to cause variability in our financial performance.

The Americas region includes North America (primarily United States and Canada) and Latin America. The EMEA region includes Europe, Russia, the Middle East, India and Africa. The APAC region primarily includes East and Southeast Asia and Australia.

The Tax Cuts and Jobs Act (the "Act") was signed into U.S. law on December 22, 2017. Two provisions of the new law had an immediate impact.

First, the U.S. corporate tax rate was reduced from 35% to 21%. This rate reduction required us to re-measure our net deferred tax assets, which were originally recorded assuming a future tax benefit at the 35% rate. We estimate that the total impact of this re-measurement of our net deferred tax assets will be about \$45.1 million. During the three and nine months ended June 29, 2018, we recorded a provisional tax expense of \$1.6 million and \$41.8 million, respectively, related to re-measuring our net deferred tax assets as a result of the rate reduction. As we have a September fiscal year end, the change to the lower corporate tax rate will be phased in. As a result of this phase in, the remainder, or about \$3.3 million, will be charged to income tax expense over the balance of fiscal year 2018.

Second, as part of the transition to a modified territorial system, the Act imposes a one-time transition tax on the unremitted earnings of our foreign subsidiaries. We recorded a provisional discrete tax expense related to the one-time transition tax of \$173.1 million during the nine months ended June 29, 2018, and none during the three months ended June 29, 2018. We intend to elect to pay this tax over an eight-year period.

The Securities and Exchange Commission has issued guidance allowing companies a measurement period, not to exceed one-year from the date of enactment, to refine their estimates of the tax impact of the new law. We fully expect that we will true up our estimates of these tax impacts of the Act over the measurement period.

On January 22, 2018, a continuing budget resolution was signed into law that included a provision to extend the moratorium on the 2.3% medical device excise tax for two more years, or until January 1, 2020. This tax has had, and may continue to have, a negative impact on our gross margin when the moratorium expires.

**Oncology Systems.** Our Oncology Systems business designs, manufactures, sells and services hardware and software products for treating cancer with conventional radiotherapy, and advanced treatments, such as fixed field intensity-modulated radiation therapy ("IMRT"), image-guided radiation therapy ("IGRT"), volumetric modulated arc therapy ("VMAT"), stereotactic radiotherapy, stereotactic body radiotherapy and brachytherapy. Our software solutions also include informatics software for information management, clinical knowledge exchange, patient care management, practice management and decision-making support for comprehensive cancer clinics, radiotherapy centers and medical oncology practices.

Our primary goal in the Oncology Systems business is to promote the adoption of more advanced and effective cancer treatments. In our view, the fundamental market forces that drive long-term growth in our Oncology Systems business are the rise in cancer cases; technology advances and product developments that are leading to improvements in patient care; customer demand for the more advanced and effective cancer treatments that we enable; competitive conditions among hospitals and clinics to offer such advanced treatments; continued improvement in safety and cost efficiency in delivering radiation therapy; and underserved medical needs outside of the United States. Approximately

half of Oncology Systems gross orders and revenues come from international markets, within which certain emerging markets typically can have lower gross margins and longer installation cycles since a significant number of the hardware products go into new sites for which treatment vaults need to be constructed. We have also seen an increased portion of gross orders and revenues coming from services and software licenses, both of which have higher gross margin percentages than our hardware products. We have also been investing a higher portion of our Oncology Systems research and development budget in software and software-related products.

The radiation oncology market in North America is largely characterized by replacements of older machines, with periodic increases in demand driven by the introduction of new technologies. Reimbursement rates in the United States have generally supported a favorable return on investment for the purchase of new radiotherapy equipment and technologies. While we believe that improved product functionality, greater cost-effectiveness and prospects for better clinical outcomes with new capabilities such as IMRT, IGRT and VMAT tend to drive demand for radiotherapy products, large changes in reimbursement rates or reimbursement structure can affect customer demand and cause market shifts. We believe that growth of the radiation oncology market in the United States could be impacted as customers' decision-making processes are complicated by the uncertainties surrounding the Affordable Care Act, the medical device tax, and reimbursement rates for radiotherapy and radiosurgery, and that this uncertainty will likely continue in future fiscal years. We believe this uncertainty could impact transaction size, timing and purchasing processes, and also contribute to increased quarterly business variability. Given all the dynamic elements affecting this market, as outlined above, we believe the North America market will continue to grow in the low to mid-single digit range.

In the radiation oncology markets outside of North America, we expect the EMEA market to grow over the long term with varying growth rates across the region. In APAC, we expect China to lead longer-term regional growth, with slower growth in the Japanese market. Latin America is currently experiencing volatility; however, our long-term outlook is cautiously optimistic. Overall, we believe the global radiation oncology market can grow over the long term, in constant currencies, in the low to mid-single-digit range.

In the three months ended June 29, 2018, Oncology Systems revenues increased 18% and gross margin percentage increased by 0.3 percentage points compared to the year-ago period.

In the three months ended June 29, 2018, Oncology Systems gross orders increased 11%, compared to the year-ago period, primarily due to an increase in gross orders of 13% from our international regions and an increase of 9% from our North America region. On a constant currency basis, Oncology Systems gross orders and international gross orders both increased by 9% in the three months ended June 29, 2018, compared to the year-ago period.

Varian Particle Therapy. Our VPT business develops, designs, manufactures, sells and services products and systems for delivering proton therapy, another form of external beam radiotherapy using proton beams, for the treatment of cancer.

In the three months ended June 29, 2018, VPT revenues decreased \$26.5 million and gross orders decreased \$118.8 million compared to the year-ago period.

In the three months ended June 29, 2018, we recorded an \$11.0 million impairment charge on our Maryland Proton Treatment Center ("MPTC") subordinated loan due to the expected difference in value between the loan currently held by us and the value of the security to be issued to us in exchange as part of the refinancing expected in the fourth quarter of fiscal year 2018.

In March 2017, California Proton Treatment Center, LLC ("Original CPTC") filed for bankruptcy and concurrently entered into a Debtor-in-Possession facility (the "DIP Facility") with ORIX Capital Markets, LLC, J.P. Morgan and Varian (the "Lenders").

In September 2017, the Lenders to the Scripps Proton Therapy Center ("Scripps") signed a Transition Agreement to transition the operations of the center from Scripps to a new operator. On December 6, 2017 ("Closing Date"), the Bankruptcy Court approved the sale of Original CPTC to the California Proton Therapy Center, LLC ("CPTC"), an entity owned by the Lenders. The Lenders purchased all assets and assumed \$112.0 million ("Term Loan") of Original CPTC's outstanding liabilities. On December 13, 2017, the Bankruptcy Court dismissed the bankruptcy filing of Original CPTC.

On the Closing Date, the Lenders entered into a Credit Agreement with Original CPTC of which the terms of the Original CPTC Loans, DIP Facility and accrued interest (collectively "Former Loans") were modified. As a result, we received a 47.08% equity ownership in CPTC. Original CPTC has assigned all its Former Loans to CPTC at an amount of \$112.0 million, the partially satisfied loan balance.

Per the terms of the Credit Agreement, our portion of the \$112.0 million is \$53.5 million; the remainder is allocated between ORIX and J.P. Morgan. The \$53.5 million is composed of four Tranches: Tranche A of \$2.0 million, Tranche B of \$7.2 million, Tranche C of \$15.6 million, and Tranche D of \$28.7 million (collectively the "Term Loan"). The

maturity date of the Term Loan is three years from the Closing Date. The Term Loan is secured by the assets of CPTC.

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In addition, the Lenders have committed to lend up to \$15.0 million in Revolving Loans. Our share of the funding commitment from the Revolving Loan is \$7.2 million and as of June 29, 2018, we have funded \$3.1 million. The Revolving Loan accrues paid-in-kind interest at 10% per annum and has a maturity date one year from the Closing Date.

All of the Tranches of the Term Loan accrue paid-in-kind interest at 7.5% per annum, except the Tranche B, which accrues paid-in-kind interest at 10% per annum. The seniority of these loans is as follows: Revolving Loan, Tranche A, Tranche B, Tranche C and Tranche D. If CPTC is in default, the interest of the Tranche A, C and D will increase to 9.5% and the interest of the Tranche B and the Revolving Loan will increase to 12.0%.

Considering Original CPTC's financial difficulties, the modification of the original terms of the Former Loans, and the Lenders agreement to grant a concession on the Original CPTC Loans, we classified this transaction as a troubled debt restructuring ("TDR"). We did not have any unamortized fees from the Former Loans and any prepayment penalties. As a result, the cost basis and fair value of our outstanding term loan as of June 29, 2018 to CPTC is \$53.5 million, which approximates the carrying value of the Former Loans prior to TDR.

We used a discounted cash flow approach and determined the fair value of CPTC's equity as of Closing Date was \$20.1 million. Our 47.08% ownership percentage amounts to a \$9.5 million equity interest in CPTC. Since the common stock received was in addition to a loan receivable partially satisfied through the bankruptcy proceedings, in accordance with the TDR accounting guidance, we recorded the equity interest at fair value and as an offset to the reinstated loan balance. The equity investment in CPTC is accounted for under the equity method of accounting and we account for our equity method share of the income or loss of CPTC on a quarter lag basis. We recorded a loss of \$3.4 million in the three months ended June 29, 2018 in selling, general and administrative expenses on the Condensed Consolidated Statements of Earnings.

As of June 29, 2018, we had a total of \$56.6 million in loans outstanding to CPTC and \$112.6 million carrying value of loans outstanding to VPT customers, including accrued interest, available-for-sale securities, notes receivable and short-term senior secured debt. See Note 16, "VPT Loans and Investment" of the Notes to the Condensed Consolidated Financial Statements for further information.

This discussion and analysis of our financial condition and results of operations is based upon and should be read in conjunction with the Condensed Consolidated Financial Statements and the Notes included elsewhere in this Quarterly Report on Form 10-Q and the Consolidated Financial Statements, the Notes to the Consolidated Financial Statements and the related Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended September 29, 2017 (the "2017 Annual Report"), as well as the information contained under Part I, Item 1A "Risk Factors" of the 2017 Annual Report and Part II, Item 1A "Risk Factors" of this Quarterly Report on Form 10-Q and our Quarterly Report for the quarter ended March 30, 2018, and other information provided from time to time in our other filings with the SEC.

#### Critical Accounting Estimates

The preparation of our financial statements and related disclosures in conformity with accounting principles generally accepted in the United States ("GAAP") requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and assumptions are based on historical experience and on various other factors that we believe are reasonable under the circumstances. We periodically review our accounting policies, estimates and assumptions and make adjustments when facts and circumstances dictate. In addition to the accounting policies that are more fully described in the Notes to the Consolidated Financial Statements included in our 2017 Annual Report on Form 10-K, we consider the critical accounting policies described below to be affected by critical accounting estimates. Our critical accounting policies that are affected by accounting estimates include revenue recognition, share-based compensation expense, valuation of allowance for doubtful accounts, impairment of investments and notes receivable, valuation of inventories, assessment of recoverability of goodwill and intangible assets, valuation of warranty obligations, assessment of loss contingencies, valuation of defined benefit pension and post-retirement benefit plans, valuation of derivative instruments, and taxes on earnings. Such accounting

policies require us to use judgments, often as a result of the need to make estimates and assumptions regarding matters that are inherently uncertain, and actual results could differ materially from these estimates. For a discussion of how these estimates and other factors may affect our business, see Part II, Item 1A, "Risk Factors."

#### Revenue Recognition

Our revenues are derived primarily from the sale of hardware and software products, and services from our Oncology Systems and VPT businesses. We recognize revenues net of any value added or sales tax and net of sales discounts.

We frequently enter into revenue arrangements with customers that contain multiple performance obligations including hardware, software, and services. Judgments as to the stand alone selling price and allocation of consideration from an arrangement to the individual performance obligations, and the appropriate timing of revenue recognition are critical with respect to these arrangements.

Changes to the elements in an arrangement and the amounts allocated to each element could affect the timing and amount of revenue recognition. Revenue recognition also depends on the timing of shipment, readiness of customers' facilities for installation, installation requirements, and availability of products or customer acceptance terms. If shipments or installations are not made on scheduled timelines or if the products are not accepted by the customer in a timely manner, our reported revenues may differ materially from expectations.

Service revenues include revenues from hardware service contracts, software service agreements, bundled support arrangements, paid services and trainings, and parts that are sold by our service department. Revenues allocated to service contracts are generally recognized ratably over the period of the related contracts.

We recognize revenues on proton therapy contracts over the life of the project as costs are incurred. We recognize revenue related to our proton therapy systems over time because the customer controls the work in process, the Company's performance does not create an asset with alternative use to the Company, and the Company has an enforceable right to payment for performance completed to date. Changes in estimates of total contract revenue, total contract cost or the extent of progress towards completion are recognized in the period in which the changes in estimates are identified. Estimated losses on contracts are recognized in the period in which the loss is identified. In circumstances in which the final outcome of a contract cannot be reliably estimated but a loss on the contract is not expected, we recognize revenues to the extent of costs incurred until reliable estimates can be made. If and when we can make reliable estimates, revenues and costs of revenues are adjusted in the same period. Recognizing revenue over time based on costs incurred requires the use of estimates in determining revenues, costs and profits and in assigning the dollar amounts to relevant accounting periods. Because the estimates must be periodically reviewed and appropriately adjusted, if our estimates prove to be inaccurate or circumstances change over time, we may be forced to adjust revenues or even record a contract loss in later periods.

For a discussion of the impact of ASC 606 on our revenue recognition, please see Note 1, "Summary of Significant Accounting Policies" of the Notes to the condensed consolidated financial statements.

#### Share-based Compensation Expense

We grant our employees restricted stock units, stock options, performance units and performance options, permit employees to purchase shares under the VMS employee stock purchase plan and grant our directors restricted stock units. We value our stock options and performance options granted and the option component of the shares of VMS common stock purchased under the employee stock purchase plan using the Black-Scholes option-pricing model. We value our performance units that were granted prior to fiscal year 2018, which contain a market condition, using the Monte Carlo simulation model. The determination of fair value of share-based payment awards on the date of grant under both the Black-Scholes option-pricing model and the Monte Carlo simulation model is affected by VMS's stock price, as well as the input of other subjective assumptions, including the expected terms of share-based awards and the expected price volatilities of shares of VMS common stock and peer companies that are used to assess certain performance targets over the expected term of the awards, and the expected dividend yield of shares of VMS common stock. For performance units granted in fiscal year 2018, we value them at fair market value and adjust the value according to the contingent market condition as specified in the terms and conditions of those awards.

The expected term of our stock options is based on the observed and expected time to post-vesting exercise and post-vesting cancellations of stock options by our employees. We use a blended volatility in deriving the expected volatility assumption for our stock options. Blended volatility represents the weighted average of implied volatility and historical volatility. Implied volatility is derived based on traded options on VMS common stock. In determining the grant date fair value of our performance units, historical volatilities of shares of VMS common stock, as well as the shares of common stock of peer companies, were used to assess certain performance targets. The risk-free interest rate assumption is based upon observed interest rates appropriate for the term of our stock awards. The dividend yield assumption is based on our history and expectation of no dividend payouts. If factors change and we employ different assumptions in future periods, the compensation expense that we record may differ significantly from what we have

recorded in the current period.

Beginning in the first quarter of fiscal year 2018, we now record forfeitures as they occur. We estimate the probability that certain performance conditions that affect the vesting of performance units will be achieved, and recognize expense only for those awards expected to vest. If the actual number of performance units that vest based on achievement of performance

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conditions are materially different from our estimates, the share-based compensation expense could be significantly different from what we have recorded in the current period.

#### Allowance for Doubtful Accounts

We evaluate the creditworthiness of our customers prior to authorizing shipment for all major sale transactions. Except for government tenders, group purchases and orders with letters of credit in Oncology Systems our payment terms often require payment of a small portion of the total amount due when the customer signs the purchase order, a significant amount upon transfer of risk of loss to the customer and the remaining amount upon completion of the installation. On a quarterly basis, we evaluate aged items in the accounts receivable aging report and provide an allowance in an amount we deem adequate for doubtful accounts. If our evaluation of our customers' financial conditions does not reflect our future ability to collect outstanding receivables, additional provisions may be needed and our operating results could be negatively affected.

#### Impairment of Investments and Notes Receivable

We recognize an impairment charge when the declines in the fair values of our available-for-sale investments below their cost basis are determined to be other than temporary impairments ("OTTI"). We monitor our available-for-sale investments for possible OTTI on an ongoing basis. When there has been a decline in fair value of a debt security below the amortized cost basis, we recognize OTTI if: (i) we have the intention to sell the security; (ii) it is more likely than not that we will be required to sell the security before recovery of the entire amortized cost basis; or (iii) we do not expect to recover the entire amortized cost basis of the security. We assess the fair value of our available-for-sale securities, which are classified in the level 3 fair value hierarchy based on the income approach by using the discounted cash flow model with key assumptions that include discount rates corresponding to the terms and risks associated with the loans, as well as underlying cash flow assumptions. As of June 29, 2018, we did not have any available-for-sale investments classified as level 3 in the fair value hierarchy. As of September 29, 2017, we had \$47.4 million, which comprised of the fair value our Original CPTC Loans, of available-for-sale investments classified as level 3 in the fair value hierarchy. See Note 5, "Fair Value" and Note 16, "VPT Loans and Investment" of the Notes to the Condensed Consolidated Financial Statements.

We also have investments in privately-held companies, some of which are in the startup or development stages. We monitor these investments for events or circumstances indicative of potential impairment, and we make appropriate reductions in carrying values if we determine that an impairment charge is required, based primarily on the financial condition, near-term prospects and recent financing activities of the investee. These investments are inherently risky because the markets for the technologies or products these companies are developing are typically in the early stages and may never materialize.

At times, we advance notes to third parties, including our customers. We regularly assess these notes for collectability by considering internal factors such as historical experience, credit quality, age of the note balances as well as external factors such as economic conditions that may affect the note holder's ability to pay.

Our ongoing consideration of all the factors described above could result in impairment charges in the future, which could adversely affect our operating results.

#### Inventories

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

#### Goodwill, Intangible Assets and Impairment Assessment

Goodwill represents the excess of the purchase price in a business over the fair value of net tangible and intangible assets acquired. The determination of the value of the intangible assets acquired involves certain judgments and estimates. These judgments can include, but are not limited to, the cash flows that an asset is expected to generate in the future and the appropriate discount weighted-average cost of capital ("WACC"). Each period, we evaluate the estimated remaining useful lives of purchased intangible assets and whether events or changes in circumstances

warrant a revision to the remaining periods of amortization.

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Goodwill is allocated to reporting units expected to benefit from the business combination. We evaluate our reporting units when changes in our operating structure occur, and if necessary, reassign goodwill using a relative fair value allocation approach. Goodwill is tested for impairment at the reporting unit level on an annual basis or whenever events or changes in circumstances indicate its carrying value may not be recoverable. We can opt to perform a qualitative assessment to test a reporting unit's goodwill for impairment or we can directly perform a quantitative assessment. Various factors are considered in the qualitative assessment, including macroeconomic conditions, industry and market considerations, financial performance and other relevant events affecting the reporting unit. Based on our qualitative assessment, if we determine that the fair value of a reporting unit is more likely than not (i.e., a likelihood of more than 50 percent) to be less than its carrying amount, the quantitative assessment will be performed. The quantitative assessment compares the fair value of a reporting unit against its carrying amount, including the goodwill allocated to each reporting unit. We determine the fair value of our reporting units based on a combination of income and market valuation approaches. The income approach is based on the present value of estimated future cash flows that the reporting unit is expected to generate, and the market approach is based on a market multiple calculated for each reporting unit based on market data of other companies engaged in similar business. Any excess of the reporting unit's carrying value over its fair value will be recorded as an impairment loss.

Determining the fair value of a reporting unit involves the use of significant estimates and assumptions. These estimates and assumptions include revenue growth rates, operating margins and working capital needs to calculate projected future cash flows, WACC, future economic and market conditions, estimation of the long-term rate of growth for our business and determination of appropriate market comparables. We base our fair value estimates on assumptions we believe to be reasonable but that are inherently uncertain. Actual future results related to assumed variables could differ from these estimates. In addition, we make certain judgments and assumptions in allocating assets and liabilities to determine the carrying values for each reporting unit.

We have two reporting units: (i) Oncology Systems and (ii) VPT, with \$188.1 million and \$51.8 million in goodwill, respectively, as of June 29, 2018. Based upon the most recent annual goodwill analysis during the fourth quarter of fiscal year 2017, VPT's fair value was 21% in excess of its carrying value, and we believe each of the assumptions used to calculate VPT's fair value to be reasonable. However, VPT could be at risk for goodwill impairment because adjustments to revenue growth rates, operating margins, WACC and/or our working capital used in the fair value calculation could lead to an impairment.

#### Warranty Obligations

We warrant most of our products for a specific period of time, usually 12 months from installation, against material defects. We provide for the estimated future costs of warranty obligations in cost of revenues when the related revenues are recognized. The accrued warranty costs represent our best estimate at the time of sale of the total costs that we will incur to repair or replace product parts that fail while still under warranty. The amount of accrued estimated warranty costs obligation for established products is primarily based on historical experience as to product failures adjusted for current information on repair costs. For new products, estimates will include historical experience of similar products, as well as reasonable allowance for start-up expenses. Actual warranty costs could differ from the estimated amounts. On a quarterly basis, we review the accrued balances of our warranty obligations and update the historical warranty cost trends, if required. If we were required to accrue additional warranty costs in the future, it would have a negative effect on our operating results.

#### Loss Contingencies

From time to time, we are a party to or otherwise involved in legal proceedings, claims and government inspections or investigations or other legal matters, both inside and outside the United States, arising in the ordinary course of our business or otherwise. We accrue amounts, to the extent they can be reasonably estimated, that we believe are adequate to address any liabilities related to legal proceedings and other loss contingencies that we believe will result in a probable loss. Such matters are subject to many uncertainties, outcomes are not predictable with assurance, and actual liabilities could significantly exceed our estimates of potential liabilities. In addition, we are subject to a variety of environmental laws around the world. Those laws regulate multiple aspects of our operations, including the handling, storage, transport and disposal of hazardous substances. They impose costs on our operations. In connection with our past and present operations and facilities, we record environmental remediation liabilities when we conclude

that environmental assessments or remediation efforts are probable and we believe we can reasonably estimate the costs of those efforts. Our accrued environmental costs represent our best estimate of the total costs of assessments and remediation and the time period over which we expect to incur those costs. We review these accrued balances quarterly. If we were required to increase or decrease the accrued environmental costs in the future, it would adversely or favorably impact our operating results.

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#### Defined Benefit Pension Plans

We sponsor five defined benefit pension plans in Germany, Japan, Switzerland and the United Kingdom covering employees who meet the applicable eligibility requirements in these countries. Several statistical and other factors that attempt to anticipate future events are used in calculating the expenses and liabilities related to the aforementioned plans. These factors include assumptions about the discount rate, expected return on plan assets, and rate of future compensation increases, all of which we determine within certain guidelines. In addition, we also use assumptions, such as withdrawal and mortality rates, to calculate the expenses and liabilities. The actuarial assumptions we use are long-term assumptions and may differ materially from actual experience particularly in the short term due to changing market and economic conditions and changing participant demographics. These differences may have a significant impact on the amount of defined benefit pension plan expenses we record.

The expected rates of return on the various defined benefit pension plans' assets are based on the asset allocation of each plan and the long-term projected return on those assets. The discount rate enables us to state expected future cash flows at a present value on the measurement date. The discount rates used for defined benefit plans are primarily based on the current effective yield of long-term corporate bonds that are of high quality with satisfactory liquidity and credit rating with durations corresponding to the expected durations of the benefit obligations. A change in the discount rate may cause the present value of benefit obligations to change significantly.

#### Valuation of Derivative Instruments

We use foreign currency forward contracts to reduce the effects of currency rate fluctuations on sales transactions denominated in foreign currencies and on net monetary assets and liabilities denominated in foreign currencies. These foreign currency forward contracts are derivative instruments and are measured at fair value. There are three levels of inputs that may be used to measure fair value (see Note 5, "Fair Value" of the Notes to the Consolidated Financial Statements). The fair value of foreign currency forward contracts is calculated primarily using Level 2 inputs, which include currency spot and forward rates, interest rate and credit or non-performance risk. The spot rate for each currency is the same spot rate used for all balance sheet translations at the measurement date and sourced from our major trading banks. The forward point values for each currency and the London Interbank Offered Rate ("LIBOR") to discount assets and liabilities are interpolated from commonly quoted broker services. One-year credit default swap spreads of the counterparty at the measurement date are used to adjust derivative assets, all of which mature in 13 months or less, for non-performance risk. We are required to adjust derivative liabilities to reflect the potential non-performance risk to lenders based on our incremental borrowing rate. Each contract is individually adjusted using the counterparty credit default swap rates (for net assets) or our borrowing rate (for net liabilities). The use of Level 2 inputs in determining fair values requires certain management judgment and subjectivity. Changes to these Level 2 inputs could have a material impact on the valuation of our derivative instruments. There were no transfers of assets or liabilities between fair value measurement levels during the nine months ended of fiscal years 2018 and 2017.

#### Taxes on Earnings

We are subject to taxes on earnings in both the United States and numerous foreign jurisdictions. As a global taxpayer, significant judgments and estimates are required in evaluating our tax positions and determining our provision for taxes on earnings. We account for uncertainty in income taxes following a two-step approach for recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining whether the weight of available evidence indicates that it is more likely than not that, based on the technical merits, the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement. Recognition and measurement are based on management's best judgment given the facts, circumstances and information available at the end of the accounting period.

Generally, the carrying value of our net deferred tax assets assumes that we will be able to generate sufficient future taxable earnings in the applicable tax jurisdictions to utilize these deferred tax assets. Should we conclude it is more likely than not that we will be unable to recover our deferred tax assets in these tax jurisdictions, we would increase our valuation allowance and our tax provision would increase in the period in which we make such a determination. The Act was signed into law on December 22, 2017. Among other changes, the Act reduces the U.S. corporate tax rate from 35% to 21%. The reduction in the rate required us to re-measure our net deferred tax assets that were originally

recorded assuming a future tax benefit at the 35% rate. During the three and nine months ended June 29, 2018, we recorded a provisional tax expense of \$1.6 million and \$41.8 million, respectively, related to re-measuring our net deferred tax assets as a result of the rate reduction.

Our foreign earnings are taxed at rates that are, on average, lower than U.S. rates. Our effective tax rate is impacted by existing tax laws in both the United States and in the respective countries in which our foreign subsidiaries do business. In addition, a

decrease in the percentage of our total earnings from foreign countries, or a change in the mix of foreign countries among particular tax jurisdictions could increase or decrease our effective tax rate.

As part of the transition to a modified territorial system, the Act imposes a one-time transition tax on the unremitted earnings of our foreign subsidiaries. We recorded a \$173.1 million provisional discrete tax expense related to the one-time transition tax during the nine months ended June 29, 2018 and none during the three months ended June 29, 2018. We intend to elect to pay this tax over an eight-year period. We intend to elect to pay this tax over an eight-year period. The transition to a modified territorial regime and the one-time transition tax on unremitted earnings has caused us to re-evaluate our intentions with respect to the unremitted earnings of our foreign subsidiaries. In the past, we did not accrue U.S. taxes on certain undistributed profits of certain foreign subsidiaries because the earnings were considered to be indefinitely reinvested. In light of the changes to the taxation of foreign earnings in the Act, we no longer consider the earnings of our foreign subsidiaries to be indefinitely reinvested.

On December 22, 2017, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 118 (“SAB 118”). This guidance allows registrants a “measurement period,” not to exceed one year from the date of enactment, to complete their accounting for the tax effects of the Act. SAB 118 further directs that during the measurement period, registrants who are able to make reasonable estimates of the tax effects of the Act should include those amounts in their financial statements as “provisional” amounts. Registrants should reflect adjustments over subsequent periods as they are able to refine their estimates and complete their accounting for the tax effects of the Act. We have made reasonable estimates and recorded provisional amounts within the meaning of SAB 118. Also, it is expected that the U.S. Treasury will issue regulations and other guidance on the application of certain provisions of the Act. In subsequent periods, but within the measurement period, we will analyze that guidance and other necessary information to refine our estimates and complete our accounting for the tax effects of the Act.

## Results of Operations

### Fiscal Year

Our fiscal year is the 52- or 53-week period ending on the Friday nearest September 30. Fiscal year 2018 is the 52-week period ending September 28, 2018, and fiscal year 2017 was the 52-week period that ended on September 29, 2017. The fiscal quarters ended June 29, 2018 and June 30, 2017 were both 13-week periods.

Discussion of Results of Operations for the Three and Nine Months Ended June 29, 2018 Compared to the Three and Nine Months Ended June 30, 2017

### Total Revenues

Revenues by sales classification (Dollars in millions)	Three Months Ended			Nine Months Ended		
	June 29, 2018	June 30, 2017	Percent Change	June 29, 2018	June 30, 2017	Percent Change
Product	\$365.0	\$320.2	14 %	\$1,124.4	\$994.3	13 %
Service	344.1	312.6	10 %	993.1	903.2	10 %
Total Revenues	\$709.1	\$632.8	12 %	\$2,117.5	\$1,897.5	12 %
Product as a percentage of total revenues	51	% 51	%	53	% 52	%
Service as a percentage of total revenues	49	% 49	%	47	% 48	%

Total product and service revenues increased in the three and nine months ended June 29, 2018, compared to the year-ago periods, primarily due to an increase in revenues from Oncology Systems, partially offset by a decrease in product revenues from VPT.

Revenues by geographical region (Dollars in millions)	Three Months Ended					Nine Months Ended				
	June 29, 2018	June 30, 2017	Percent Change	Constant Currency (1)		June 29, 2018	June 30, 2017	Percent Change	Constant Currency (1)	
Americas	\$342.6	\$336.3	2 %	2 %		\$1,039.5	\$976.1	7 %	6 %	
EMEA	229.7	169.5	35 %	28 %		676.5	538.8	26 %	16 %	
APAC	136.8	127.0	8 %	6 %		401.5	382.6	5 %	4 %	
Total Revenues	\$709.1	\$632.8	12 %	10 %		\$2,117.5	\$1,897.5	12 %	9 %	
North America	\$318.1	\$324.1	(2) %	(2) %		\$982.3	\$925.8	6 %	6 %	
International <sup>(2)</sup>	391.0	308.7	27 %	22 %		1,135.2	971.7	17 %	11 %	
Total Revenues	\$709.1	\$632.8	12 %	10 %		\$2,117.5	\$1,897.5	12 %	9 %	
North America as a percentage of total revenues	46	% 51	%			46	% 49	%		
International as a percentage of total revenues	54	% 49	%			54	% 51	%		

(1) Constant currency is the percent change excluding the effect of foreign currency fluctuations against the U.S. Dollar.

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

The Americas revenues increased in the three and nine months ended June 29, 2018, compared to the year-ago periods, due to an increase in revenues from Oncology Systems being offset by a decrease in revenues from VPT. EMEA revenues increased in the three and nine months ended June 29, 2018, compared to the year-ago periods, primarily due to an increase in revenues from Oncology Systems. APAC revenues increased in the three and nine months ended June 29, 2018, compared to the year-ago periods, due to an increase in revenues from Oncology Systems, partially offset by a decrease in revenues from VPT.

#### Oncology Systems Revenues

Revenues by sales classification (Dollars in millions)	Three Months Ended					Nine Months Ended				
	June 29, 2018	June 30, 2017	Percent Change	Constant Currency		June 29, 2018	June 30, 2017	Percent Change	Constant Currency	
Product	\$326.9	\$253.7	29 %	26 %		\$1,028.9	\$870.9	18 %	15 %	
Service	340.3	310.7	10 %	7 %		985.7	896.6	10 %	7 %	
Total Oncology Systems Revenues	\$667.2	\$564.4	18 %	16 %		\$2,014.6	\$1,767.5	14 %	11 %	
Product as a percentage of total Oncology Systems revenues	49	% 45	%			51	% 49	%		
Service as a percentage of total Oncology Systems revenues	51	% 55	%			49	% 51	%		
Oncology Systems revenues as a percentage of total revenues	94	% 89	%			95	% 93	%		

Oncology Systems product revenues increased in the three and nine months ended June 29, 2018, compared to the year-ago periods, primarily due to an increase in revenues from higher volumes of hardware unit shipments and an increase in revenues from our software products.

Oncology Systems service revenues, which now include performance obligations for installation, training and warranty, increased in the three and nine months ended June 29, 2018, compared to the year-ago periods, primarily due to ongoing customer adoption of service contracts as the warranty periods on our TrueBeam systems expire and an increase in the number of customers as the installed base of our products continues to grow.



Revenues by geographical region (Dollars in millions)	Three Months Ended			Nine Months Ended				
	June 29, 2018	June 30, 2017	Percent Change	Constant Currency	June 29, 2018	June 30, 2017	Percent Change	Constant Currency
Americas	\$323.2	\$286.9	13 %	13 %	\$981.8	\$909.7	8 %	8 %
EMEA	208.5	157.6	32 %	24 %	633.2	494.1	28 %	18 %
APAC	135.5	119.9	13 %	11 %	399.6	363.7	10 %	9 %
Total Oncology Systems Revenues	\$667.2	\$564.4	18 %	16 %	\$2,014.6	\$1,767.5	14 %	11 %
North America	\$298.7	\$274.7	9 %	9 %	\$924.6	\$859.4	8 %	7 %
International	368.5	289.7	27 %	22 %	1,090.0	908.1	20 %	14 %
Total Oncology Systems Revenues	\$667.2	\$564.4	18 %	16 %	\$2,014.6	\$1,767.5	14 %	11 %
North America as a percentage of total Oncology Systems revenues	45	% 49	%		46	% 48	%	
International as a percentage of total Oncology Systems revenues	55	% 51	%		54	% 52	%	

Americas Oncology Systems revenues increased in the three months ended June 29, 2018, compared to the year-ago period, primarily due to an increase in revenues from hardware products and services. Americas Oncology Systems revenues increased in the nine months ended June 29, 2018, compared to the year-ago period, primarily due to higher volumes of hardware unit shipments in North America, and to a lesser extent, an increase in revenues from services in North America, partially offset by a decrease in revenues from software licenses.

EMEA Oncology Systems revenues increased in the three and nine months ended June 29, 2018, compared to the year-ago periods, primarily due to an increase in revenues from hardware products and, to a lesser extent, increases in revenues from services and software licenses. EMEA revenues were further impacted by a favorable foreign currency exchange impact in fiscal year 2018.

APAC Oncology Systems revenues increased in the three and nine months ended June 29, 2018, compared to the year-ago periods, primarily due to an increase in revenues from services and, to a lesser extent, an increase in revenues from hardware products, partially offset by a decrease in revenues from software licenses.

Variations of higher and lower revenues between the North America and international regions are impacted by regional factors influencing our gross orders, which include government stimulus programs, philanthropy/donations, economic and political instability in some countries, uncertainty created by health care reform (such as the excise tax on the sale of most medical devices, Medicare reimbursement rates and consolidation of free standing clinics in the United States), and different technology adoption cycles. See further discussion of orders under "Gross Orders."

#### Varian Particle Therapy

Revenues by sales classification (Dollars in millions)	Three Months Ended			Nine Months Ended		
	June 29, 2018	June 30, 2017	Percent Change	June 29, 2018	June 30, 2017	Percent Change
Product	\$38.1	\$66.5	(43 )%	\$95.5	\$123.4	(23 )%
Service	3.8	1.9	95 %	7.4	6.6	12 %
Total Varian Particle Therapy Revenues	\$41.9	\$68.4	(39 )%	\$102.9	\$130.0	(21 )%
VPT revenues as a percentage of total revenues	6	% 11	%	5	% 7	%

Revenues from VPT decreased in the three and nine months ended June 29, 2018, compared to the year-ago periods, primarily due to the completion of the financing for the Georgia Proton Treatment Center in June 2017, which resulted in \$45.6 million of revenues recorded in the three months ended June 30, 2017.

## Gross Margin

Dollars by segment (Dollars in millions)	Three Months Ended			Nine Months Ended		
	June 29, 2018	June 30, 2017	Percent Change	June 29, 2018	June 30, 2017	Percent Change
Oncology Systems	\$305.5	\$256.8	19 %	\$923.3	\$795.7	16 %
Varian Particle Therapy	8.1	8.7	(6 )%	11.6	12.4	(6 )%
Gross margin	\$313.6	\$265.5	18 %	\$934.9	\$808.1	16 %

## Percentage by segment

Oncology Systems	45.8	%	45.5	%	45.8	%	45.0	%
Varian Particle Therapy	19.5	%	12.7	%	11.3	%	9.5	%
Total Company	44.2	%	42.0	%	44.2	%	42.6	%

## Percentage by sales classification

Total Company - Product	33.6	%	29.5	%	35.0	%	31.7	%
Total Company - Service	55.5	%	54.7	%	54.5	%	54.5	%

Oncology Systems product gross margin percentage increased to 35.2% in the three months ended June 29, 2018, from 34.0% in the year-ago period, and increased to 37.0% in the nine months ended June 29, 2018, from 35.1% in the year-ago period, primarily due to the mix of higher priced products. Oncology Systems service gross margin percentage increased to 56.0% in the three months ended June 29, 2018, from 54.9% in the year-ago period, and increased to 55.1% in the nine months ended June 29, 2018, from 54.7% in the year-ago period, primarily due to an increase in the installed base of our higher margin products.

VPT gross margin percentage increased in the three months ended June 29, 2018 compared to the year-ago period, primarily due to more revenues from higher margin projects. VPT gross margin percentage increased in the nine months ended June 29, 2018 compared to the year-ago period, primarily due to expanding service revenues and more revenues from higher margin projects.

## Research and Development

(Dollars in millions)	Three Months Ended			Nine Months Ended				
	June 29, 2018	June 30, 2017	Percent Change	June 29, 2018	June 30, 2017	Percent Change		
Research and development	\$59.5	\$55.1	8 %	\$174.3	\$158.3	10 %		
Research and development as a percentage of total revenues	8	%	9	%	8	%	8	%

Research and development expenses increased \$4.4 million and \$16.0 million in the three and nine months ended June 29, 2018, compared to the year-ago periods, primarily due to an increase in investments in new product development projects and the enhancement of existing products in Oncology Systems.

## Selling, General and Administrative, Impairment Charges, and Acquisition-Related Expenses

(Dollars in millions)	Three Months Ended			Nine Months Ended		
	June 29, 2018	June 30, 2017	Percent Change	June 29, 2018	June 30, 2017	Percent Change
Selling, general and administrative	\$138.9	\$121.4	14 %	\$397.4	\$414.1	(4 )%
Impairment charges	\$11.0	\$—	n/m	\$22.1	\$38.3	(42 )%
Acquisition-related expenses	\$12.7	\$0.5	n/m	\$33.9	\$1.4	n/m
Selling, general and administrative as a percentage of total revenues	20	% 19	%	19	% 22	%
Impairment charges as a percentage of total revenues	2	% —	%	1	% 2	%
Acquisition-related expenses as a percentage of total revenues	2	% —	%	2	% —	%

n/m = not meaningful

Selling, general and administrative expenses increased \$17.5 million in the three months ended June 29, 2018, compared to the year-ago period, primarily due to a \$12.2 million increase in employee-related costs largely due to an increase in headcount, share-based compensation and accrued bonuses, and a \$3.4 million loss on our equity investment in CPTC, partially offset by a \$2.8 million decrease in restructuring charges.

Selling, general and administrative expenses decreased \$16.7 million in the nine months ended June 29, 2018, compared to the year-ago period, primarily due to a \$35.8 million decrease in the allowance for doubtful accounts that was mostly for CPTC and another proton center in the first quarter of fiscal year 2017, a \$9.4 million decrease in litigation expenses primarily as a result of the settlement with Elekta in April 2017, and an \$8.8 million decrease in restructuring charges, partially offset by a \$28.1 million increase in employee-related costs largely due to an increase in headcount, share-based compensation and accrued bonuses, a \$5.0 million unfavorable impact when foreign-currency denominated expenses were translated into U.S. dollars, and a \$4.3 million loss on our equity investment in CPTC.

In the three and nine months ended June 29, 2018, we recorded impairment charges of \$11.0 million and \$22.1 million, respectively, related to our MPTC subordinated loan. In the first quarter of fiscal year 2017, we recorded a \$38.3 million impairment charge related to our Original CPTC loans. See Note 16, "VPT Loans and Investment" in our Notes to the Condensed Consolidated Financial Statements for additional information.

Acquisition-related expenses increased \$12.2 million and \$32.5 million in the three and nine months ended June 29, 2018, compared to the year-ago periods, primarily due to \$13.3 million and \$29.7 million, respectively, in losses related to hedging the anticipated Australian dollar Sirtex purchase price; and acquisition costs incurred in fiscal year 2018 of \$8.4 million and \$13.2 million, respectively; partially offset by the net \$9.0 million breakup fee received from Sirtex in connection with the termination of the acquisition. See, Note 9, "Derivative Instruments and Hedging Activities" in our Notes to the Condensed Consolidated Financial Statements for additional information on the hedging losses.

## Interest Income, Net

(Dollars in millions)	Three Months Ended			Nine Months Ended		
	June 29, 2018	June 30, 2017	Percent Change	June 29, 2018	June 30, 2017	Percent Change
Interest income, net	\$0.5	\$ 0.2	142 %	\$2.9	\$ 2.4	17 %

Interest income, net of interest expense, increased in the three and nine months ended June 29, 2018, compared to the year-ago periods, primarily due to a decrease in interest expense associated with a decrease in borrowings from our credit facility in fiscal year 2018, and an increase in interest income generated from our cash holdings due to higher interest rates in fiscal year 2018, partially offset by a decrease in interest income generated from our VPT loans and available-for-sale investments.

## Taxes on Earnings

	Three Months Ended			Nine Months Ended		
	June 29, 2018	June 30, 2017	Change	June 29, 2018	June 30, 2017	Change
Effective tax rate	21.2%	21.1%	0.1%	89.2%	25.7%	63.5%

Our effective tax rate increased in the nine months ended June 29, 2018, compared to the year-ago period, primarily due to the enactment of the Act, which was signed into U.S. law on December 22, 2017.

Two provisions of the new law had an immediate impact:

First, the U.S. corporate tax rate was reduced from 35% to 21%. This rate reduction required us to re-measure our net deferred tax assets which were originally recorded assuming a future tax benefit at the 35% rate. We estimate that the total impact of this re-measurement of our net deferred tax assets will be about \$45.1 million. In the three and nine months ended June 29, 2018, we recorded a provisional tax expense of \$1.6 million and \$41.8 million, respectively, related to re-measuring our net deferred tax assets as a result of the rate reduction. As we have a September fiscal year end, the change to the lower corporate tax rate will be phased in. As a result of this phase in, the remainder, or about \$3.3 million, will be charged to income tax expense over the balance of fiscal year 2018.

Second, as part of the transition to a modified territorial system, the new law imposes a one-time transition tax on the unremitted earnings of our foreign subsidiaries. We recorded a provisional discrete tax expense related to the one-time transition tax of \$173.1 million in the nine months ended June 29, 2018, and none in the three months ended June 29, 2018. We intend to elect to pay this tax over an eight-year period.

The SEC has issued guidance allowing companies a measurement period, not to exceed one-year from the date of enactment, to refine their estimates of the tax impact of the new law. We fully expect that we will true up our estimates of these tax impacts from the new tax legislation over the measurement period.

We adopted the guidance related to employee share-based payments during the period ended December 29, 2017.

Under the prior standard, the tax effect of the “excess stock deduction” related to stock-based compensation was recorded to Additional Paid-in Capital in the equity section on the Balance Sheet. For a stock-based compensation instrument, the excess stock deduction is the difference between the amount of the deduction for taxable income and the amount of book expense related to that instrument. Under the new standard, the tax effect of the “excess stock deduction” related to stock-based compensation is recorded as a discrete item to Taxes on Earnings in the Condensed Consolidated Statements of Earnings. In the three and nine months ended June 29, 2018, we recorded a discrete tax benefit of \$0.3 million and \$6.5 million, respectively, related to excess stock deduction activity. We expect that the new standard may cause our effective tax rate to be less predictable and more volatile going forward.

Our effective tax rate is impacted by the percentage of our total earnings that comes from our international region, the mix of particular tax jurisdictions within our international region, changes in the valuation of our deferred tax assets or liabilities, and changes in tax laws or interpretations of those laws. We also expect that our effective tax rate may experience increased fluctuations from period to period. See Note 14, “Taxes on Earnings” of the Notes to the Consolidated Financial Statements in our 2017 Annual Report.

## Discontinued Operations

The following table summarizes the key components of net loss from discontinued operations:

(In millions)	Nine Months Ended (1)
	June 30, 2017
Revenues	\$194.0
Cost of revenues	117.3
Gross margin	76.7
Operating expenses (2)	76.1
Operating earnings	0.6
Taxes on earnings	7.4
Net loss from discontinued operations	\$(6.8 )
Less: Net earnings from attributable to noncontrolling interests	\$0.1
Net loss from discontinued operations attributable to Varian	\$(6.9 )

(1) There was no activity in net loss from discontinued operations in the three and nine months ended June 29, 2018 or the three months ended June 30, 2017.

Operating expenses from discontinued operations included separation costs of \$34.2 million in the nine months

(2) ended June 30, 2017. Separation costs include expenses for transaction advisory services, consulting services, restructuring, and other expenses.

## Diluted Net Earnings Per Share

	Three Months Ended			Nine Months Ended		
	June 29, 2018	June 30, 2017	Percent Change	June 29, 2018	June 30, 2017	Percent Change
Diluted net earnings per share - continuing operations	\$0.79	\$ 0.75	4 %	\$0.36	\$ 1.57	(77 )%
Diluted net loss per share - discontinued operations	—	—	n/m	—	(0.07 )	n/m
Total - Diluted net earnings per share	\$0.79	\$ 0.75	4 %	\$0.36	\$ 1.50	(76 )%

n/m = not meaningful

Diluted net earnings per share from continuing operations increased in the three months ended June 29, 2018, compared to the year-ago period, primarily due to an increase in operating earnings from continuing operations.

Diluted net earnings per share from continuing operations decreased in the nine months ended June 29, 2018, compared to the year-ago period, primarily due to an increase in income tax expense as a result of the Act signed in December 2017, partially offset by an increase in operating earnings from continuing operations.

## Gross Orders

Total Gross Orders by segment (Dollars in millions)	Three Months Ended			Nine Months Ended		
	June 29, 2018	June 30, 2017	Percent Change	June 29, 2018	June 30, 2017	Percent Change
Oncology Systems	\$763.3	\$ 687.7	11 %	\$2,047.3	\$1,899.4	8 %
Varian Particle Therapy	3.8	122.6	(97 )%	51.9	154.9	(67 )%
Total Gross Orders	\$767.1	\$ 810.3	(5 )%	\$2,099.2	\$2,054.3	2 %

Gross orders are defined as new orders recorded during the period adjusted for any revisions to existing orders during the period. New orders are recorded for the total contractual amount, excluding certain pass-through items, once a written agreement for the delivery of goods or provision of services is in place and, other than VPT, when shipment of the product is expected to occur within two years, so long as any contingencies are deemed perfunctory. For our VPT business, we record



orders when construction of the related proton therapy treatment center is reasonably expected to start within two years, but only if any contingencies are deemed perfunctory. We will not record VPT orders if there are major financing contingencies, if a substantial portion of the financing for the project is not reasonably assured or if customer board approval contingencies are pending. We perform a quarterly review to verify that outstanding orders remain valid. If an order is no longer expected to be converted to revenue, we record a backlog adjustment which reduces backlog but does not impact gross orders for the period.

Gross orders in any period may not be directly correlated to the level of revenues in any particular future quarter or period since the timing of revenue recognition will vary significantly based on the delivery requirements of individual orders, acceptance schedules and the readiness of individual customer sites for installation of our products. Moreover, certain types of orders, such as orders for software or newly introduced products in our Oncology Systems segment, typically take more time from order to completion of installation and acceptance than hardware or older products. Because an order for a proton therapy system can be relatively large, an order in one fiscal period will cause gross orders in our VPT business to vary significantly, making comparisons between fiscal periods more difficult.

#### Oncology Systems Gross Orders

Gross Orders by geographical region (Dollars in millions)	Three Months Ended				Nine Months Ended			
	June 29, 2018	June 30, 2017	Percent Change	Constant Currency	June 29, 2018	June 30, 2017	Percent Change	Constant Currency
Americas	\$362.9	\$331.9	9 %	9 %	\$1,003.8	\$960.7	4 %	4 %
EMEA	259.1	204.5	27 %	21 %	648.8	544.9	19 %	12 %
APAC	141.3	151.3	(7 )%	(9 )%	394.7	393.8	— %	(1 )%
Total Oncology Systems Gross Orders	\$763.3	\$687.7	11 %	9 %	\$2,047.3	\$1,899.4	8 %	5 %

North America	\$342.7	\$314.1	9 %	9 %	\$927.6	\$901.0	3 %	3 %
International	420.6	373.6	13 %	9 %	1,119.7	998.4	12 %	8 %
Total Oncology Systems Gross Orders	\$763.3	\$687.7	11 %	9 %	\$2,047.3	\$1,899.4	8 %	5 %

The Americas Oncology Systems gross orders increased in the three and nine months ended June 29, 2018, compared to the year-ago periods, primarily due to growth in orders for our products in both North America and Latin America. EMEA Oncology Systems gross orders increased in the three and nine months ended June 29, 2018, compared to the year-ago periods, due to growth across the region. EMEA gross orders were further impacted by a favorable foreign currency exchange impact in fiscal year 2018.

APAC Oncology Systems gross orders decreased in the three months ended June 29, 2018, compared to the year-ago period, with growth in Greater China and Japan more than offset by decreases in the rest of APAC.

The trailing 12 months' growth in gross orders for Oncology Systems at the end of the third quarter of fiscal year 2018 and at the end of each of the previous three fiscal quarters was:

	Trailing 12 Months Ended			
	June 29, 2018	March 30, 2018	December 29, 2017	September 29, 2017
Americas	2%	1%	1%	1%
EMEA	20%	15%	14%	12%
APAC	(3)%	2%	3%	7%
North America	4%	2%	3%	4%
International	9%	8%	7%	7%
Total Oncology Systems Gross Orders	6%	5%	5%	5%

Consistent with the historical pattern, we expect that Oncology Systems gross orders will continue to experience regional fluctuations. Over the long-term, we expect international gross orders, specifically from emerging markets, will grow as a percentage of overall orders. Oncology Systems gross orders are affected by foreign currency fluctuations which could impact the demand for our products. In addition, government programs that stimulate the purchase of healthcare products could affect the demand for our products from period to period, and could therefore make it difficult to compare our financial results.

#### Varian Particle Therapy Gross Orders

VPT gross orders decreased in the three and nine months ended June 29, 2018, compared to the year-ago periods. There were no VPT proton therapy system orders in the three months ended June 29, 2018 and two VPT proton therapy system orders in the nine months ended June 29, 2018. The VPT proton therapy system orders in the three and nine months ended June 30, 2017 primarily included the booking of the Georgia Proton Treatment Center in June 2017.

#### Backlog

Backlog is the accumulation of all gross orders for which revenues have not been recognized and are still considered valid. Backlog is stated at historical foreign currency exchange rates and revenue is released from backlog at current exchange rates, with any difference recorded as a backlog adjustment. Our backlog at June 29, 2018 was \$2.9 billion, which includes approximately \$273 million in VPT backlog, which was an increase of 5% over the backlog at June 30, 2017. Our Oncology Systems backlog at June 29, 2018 was 6% higher than the backlog at June 30, 2017, which reflected an increase of 10% and 2% for the international regions and North America, respectively.

We perform a quarterly review to verify that outstanding orders in the backlog remain valid. Aged orders that are not expected to ultimately convert to revenues are deemed dormant and are reflected as a reduction in the backlog amounts in the period identified. Backlog adjustments are comprised of dormancies, cancellations, foreign currency exchange rate adjustments, backlog acquired from our acquisitions, and other adjustments. Gross orders do not include backlog adjustments. Backlog adjustments totaled net reductions of \$36.4 million and \$116.1 million in the three and nine months ended June 29, 2018, compared to net reductions of \$48.7 million and \$117.4 million, in the year-ago periods.

#### Liquidity and Capital Resources

Liquidity is the measurement of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, acquire businesses or make other investments or loans, repurchase shares of VMS common stock, and fund continuing operations and capital expenditures. Our sources of cash have included operations, borrowings, stock option exercises, and employee stock purchases. Our cash usage is actively managed on a daily basis to ensure the maintenance of sufficient funds to meet our needs.

#### Cash and Cash Equivalents

The following table summarizes our cash and cash equivalents:

(In millions)	June 29, 2018	September 29, 2017	Decrease
Total cash and cash equivalents	\$ 536.0	\$ 716.2	\$(180.2)

The decrease in cash and cash equivalents in the nine months ended June 29, 2018 was primarily due to debt repayments, net of borrowings, of \$331.7 million under our credit facility agreement, \$131.9 million used for the repurchase of shares of VMS common stock, \$58.7 million used for acquisitions, \$30.8 million used for purchases of property, plant, and equipment, \$11.5 million used for employee taxes withheld and paid for restricted stock units, and \$10.1 million in investments in privately-held companies, partially offset by \$346.7 million of cash provided by operating activities and \$57.1 million in proceeds from the issuance of common stock to employees.

At June 29, 2018, we had approximately \$161 million, or 30%, of cash and cash equivalents in the United States, which included approximately \$156 million held as money market funds, and approximately \$375 million, or 70%, of cash and cash equivalents was held abroad. As a result of the transition to a modified territorial system and the one-time transition tax on the unremitted earnings of our foreign subsidiaries in the Act, we expect that the cash and cash equivalents held by our foreign subsidiaries will no longer be subject to U.S. federal income tax upon a subsequent actual repatriation to the United States.





However, a portion of this cash may still be subject to foreign and state income taxes upon future remittance. In light of the changes to the taxation of foreign earnings in the Act, we no longer consider the earnings of our foreign subsidiaries to be indefinitely reinvested. As a result, we have accrued for the foreign and state income taxes that we expect would be imposed upon a future remittance.

As of June 29, 2018, most of our cash and cash equivalents that was held abroad was in U.S. Dollars and was primarily held as bank deposits. In addition to cash flows generated from operations, a significant portion of which are generated in the United States, we have used our credit facilities to meet our cash needs from time to time and expect to continue to do so in the future. Borrowings under our credit facilities may be used for working capital, capital expenditures, VMS share repurchases, acquisitions and other corporate purposes.

#### Cash Flows

(In millions)	Nine Months Ended	
	June 29, 2018	June 30, 2017
Net cash flow provided by (used in):		
Operating activities	\$346.7	\$269.4
Investing activities	(109.9 )	(78.9 )
Financing activities	(421.6 )	(375.7 )
Effects of exchange rate changes on cash and cash equivalents	4.6	1.7
Net decrease in cash and cash equivalents	\$(180.2)	\$(183.5)

Our primary cash inflows and outflows for the nine months ended June 29, 2018, as compared to the nine months ended June 30, 2017, were as follows:

In the nine months ended June 29, 2018, net cash provided by operating activities was \$346.7 million compared to \$269.4 million in the nine months ended June 30, 2017. The \$77.3 million increase in net cash from operating activities was driven by a \$166.6 million increase in the net change from operating assets and liabilities and a \$17.8 million increase from non-cash items partially offset by a \$107.1 million decrease in net earnings.

The major contributors to the net change in operating assets and liabilities in the nine months ended June 29, 2018 were as follows:

Accrued liabilities and other long-term liabilities increased \$150.0 million primarily due to an increase in a long-term income tax liability that resulted from the enactment of the Act and an increase in accrued compensation costs.

Inventory increased \$48.5 million primarily due an increase in hardware product inventory in Oncology Systems.

Deferred revenues increased \$33.7 million primarily due to advance payments received from VPT customers and an increase in deferred service revenues in Oncology Systems.

Prepaid expenses and other assets increased \$29.8 million primarily due to a receivable for the termination fee from Sirtex and an increase in accrued interest related to our VPT loans and investments.

Accounts payable increased \$27.8 million primarily due to the timing of payments.

Trade and unbilled receivables decreased \$10.8 million primarily due to higher collections than billings partially offset by an increase in unbilled receivables.

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, timing of product shipments, product installation or customer acceptance, trade receivable collections, inventory management, and the timing and amount of tax and other payments. For additional discussion, please refer to the "Risk Factors" in Item 1A herein and in Part I, Item 1A of our 2017 Annual Report.

In the nine months ended June 29, 2018, cash used in investing activities was \$109.9 million, compared to \$78.9 million in the nine months ended June 30, 2017. In the nine months ended June 29, 2018, cash used in investing activities primarily included \$58.7 million used for business acquisitions, \$30.8 million for the purchases of property, plant and equipment, \$10.1 million in investments in privately-held companies, \$6.7 million increase in restricted cash, a \$6.0 million investment in an available-for-sale security, \$5.5 million for the purchase of a foreign currency option for the anticipated Sirtex acquisition, and \$5.3 million in loans to CPTC, partially offset by \$8.0 million received from the sale of an available-for-sale security and \$6.3 million received from repayments on notes receivables. In the nine months ended June 30, 2017, cash used in investing activities primarily included \$40.4 million for the purchases of property, plant and equipment, \$18.2 million issuance of notes receivable, and \$7.2 million in investments in privately-held companies.

In the nine months ended June 29, 2018, cash used in financing activities was \$421.6 million compared to \$375.7 million in the nine months ended June 30, 2017. In the nine months ended June 29, 2018, cash used in financing activities primarily included \$331.7 million in debt repayments, net of borrowings, and \$131.9 million for the repurchase of VMS common stock, partially offset by \$57.1 million in proceeds from the issuance of common stock to employees. In the nine months ended June 30, 2017, cash used in financing activities primarily included \$269.1 million for the repurchase of VMS common stock, \$299.5 million in debt repayments, net of borrowings, under our credit facility agreements and \$54.2 million contributed to Varex, partially offset by \$200.0 million received from Varex and \$56.7 million in proceeds from the issuance of common stock to employees.

We expect our total fiscal year 2018 capital expenditures, which typically represent construction and/or purchases of facilities, manufacturing equipment, office equipment and furniture and fixtures, as well as capitalized costs related to the implementation of software applications, will be approximately 2% of revenues in fiscal year 2018.

On April 3, 2018, we entered into the 2018 Credit Agreement with certain lenders and Bank of America, N.A. as administrative agent. The 2018 Credit Agreement provides for a five-year revolving credit facility ("2018 Revolving Credit Facility") in an aggregate principal amount of up to \$1.8 billion. The 2018 Revolving Credit Facility also includes a \$50.0 million sub-facility for the issuance of letters of credit and permits swing line loans of up to \$25 million. Under the 2018 Revolving Credit Facility, we have the right to (i) request to increase the aggregate commitments by an aggregate amount for all such requests of up to \$100.0 million and (ii) request an additional increase in the commitments or establish one or more term loans, provided that, in each case, the lenders are willing to provide such new or increased commitments and certain other conditions are met. The proceeds of the 2018 Revolving Credit Facility may be used for working capital, capital expenditures, share repurchases, permitted acquisitions and other corporate purposes, as well as to satisfy the prior outstanding obligation under the 2017 Revolving Credit Facility.

The 2018 Revolving Credit Facility replaced the 2017 Revolving Credit Facility of \$600 million.

In addition, our Japanese subsidiary ("VMS KK") has an unsecured uncommitted credit agreement with Sumitomo Mitsui Banking Corporation that enables VMS KK to borrow and have outstanding at any given time a maximum of 3.0 billion Japanese Yen (the "Sumitomo Credit Facility"). The Sumitomo Credit Facility will expire in February 2019. The following table summarizes our total short-term borrowings:

(Dollars in millions)	June 29, 2018			September 29, 2017		
	Amount	Weighted-Average Interest Rate		Amount	Weighted-Average Interest Rate	
Short-term borrowings:						
Sumitomo Credit Facility	\$18.2	0.53	%	\$—	—	%
2017 Revolving Credit Facility	—	—	%	350.0	2.36	%
Total short-term borrowings	\$18.2			\$350.0		

As of June 29, 2018, we did not have any outstanding borrowings under the 2018 Revolving Credit Facility. See Note 8, "Borrowings" of the Notes to the Condensed Consolidated Financial Statements for further information regarding the 2018 Revolving Credit Facility and the Sumitomo Credit Facility.



The following table provides additional information regarding our total short-term borrowings:

	Three Months Ended of Fiscal Year 2018
(Dollars in millions)	
Amount outstanding (at end of period)	\$18.2
Weighted average interest rate (at end of period)	0.53 %
Average amount outstanding (during period)	\$18.2
Weighted average interest rate (during period)	2.48 %
Maximum month-end amount outstanding during period	\$18.3

Our liquidity is affected by many factors, some of which result from the normal ongoing operations of our business and some of which arise from uncertainties and conditions in the United States and global economies. Although our cash requirements will fluctuate as a result of the shifting influences of these factors, we believe that existing cash and cash equivalents, cash to be generated from operations, and current or future credit facilities will be sufficient to satisfy anticipated commitments for capital expenditures, and other cash requirements for at least the next 12 months and into the foreseeable future. We currently anticipate that we will continue to utilize our available liquidity and cash flows from operations, as well as borrowed funds, to make strategic acquisitions, invest in the growth of our business, invest in advancing our systems and processes, repurchase VMS common stock, fund loan commitments and other strategic investments.

Total debt as a percentage of total capital decreased to 1.2% at June 29, 2018 from 18.7% at September 29, 2017, primarily due to a decrease in borrowings. The ratio of current assets to current liabilities increased to 1.59 to 1 at June 29, 2018 from 1.40 to 1 at September 29, 2017, primarily due to a decrease in borrowings.

#### Days Sales Outstanding

Our Oncology Systems trade and unbilled receivables days sales outstanding (“DSO”) decreased to 106 days at June 29, 2018 from 121 days at June 30, 2017. Our accounts receivable and DSO are impacted by a number of factors, primarily including: the timing of product shipments, product installation or customer acceptance, collections performance, payment terms, the mix of revenues from different regions, and the effects of economic instability. VPT's DSO is not meaningful because it is highly variable. As of June 29, 2018, approximately 3% of our net trade and unbilled receivables balance was related to customer contracts with remaining terms of more than one year.

#### Share Repurchase Program

We repurchased shares of VMS common stock under various authorizations during the periods presented as follows:

	Three Months Ended		Nine Months Ended	
(In millions, except per share amounts)	June 29, 2018	June 30, 2017	June 29, 2018	June 30, 2017
Number of shares	0.3	0.5	1.1	3.0
Average repurchase price per share	\$120.59	\$93.45	\$112.25	\$89.68
Total cost	\$39.2	\$46.8	\$131.9	\$269.1

In November 2016, the VMS Board of Directors authorized the repurchase of an additional 8.0 million shares of VMS common stock commencing on January 1, 2017. As of June 29, 2018, approximately 4.1 million shares of VMS common stock remained available for repurchase under the November 2016 authorization.

Stock repurchases may be made in the open market, in privately negotiated transactions (including accelerated share repurchase programs), or under Rule 10b5-1 share repurchase plans, and also may be made from time to time or in one or more larger blocks. All shares that were repurchased under our share repurchase programs have been retired. For more details see Note 13, "Stockholders' Equity and Noncontrolling Interests" of the Notes to the Condensed Consolidated Financial Statements for further discussion.



### Contractual Obligations

Long-term income taxes payable includes the liability for uncertain tax positions, including interest and penalties, the noncurrent portion of the one-time transition tax on unremitted foreign earnings under the Act, and may also include other long-term tax liabilities. As of June 29, 2018, our liability for uncertain tax positions was \$54.2 million, of which we do not anticipate making any payments in the next 12 months. We are unable to reliably estimate the timing of the remainder of future payments related to uncertain tax positions; we believe that existing cash and cash equivalents, cash to be generated from operations, and current or future credit facilities will be sufficient to satisfy any payment obligations that may arise related to our liability for uncertain tax positions. The Act allows taxpayers to elect to pay the one-time transition tax over a period of 8 years as follows: 8% per year for each of the first five years and 15%, 20%, and 25%, in years 6 through 8, respectively. As of June 29, 2018, the noncurrent portion of the one-time transition tax on unremitted foreign earnings was \$146.9 million.

As of June 29, 2018, we had accrued liabilities of \$5.5 million for environmental remediation liabilities. The amount accrued represents estimates of anticipated future costs and the timing and amount of actual future environmental remediation costs may vary as the scope of our obligations become more clearly defined. For more details see Note 10, "Commitments and Contingencies" of the Notes to the Condensed Consolidated Financial Statements for further discussion.

As of June 29, 2018, our outstanding commitments for the GPTC securities was \$11.8 million, and \$4.1 million for the short-term revolving loan to CPTC. The outstanding commitment for GPTC was paid in July 2018 and the outstanding commitment for the short-term revolving loan to CPTC is expected to be drawn down in the next 12 months. For more details see Note 16, "VPT Loans and Investment" of the Notes to the Condensed Consolidated Financial Statements for further discussion.

Except for the change in the outstanding balance under our revolving credit facility and the other items discussed above, there has been no significant change to the other contractual obligations we reported in our 2017 Annual Report.

### Subsequent Events

See Note 18, "Subsequent Events" of the Notes to the Condensed Consolidated Financial Statements for a discussion of our subsequent events.

### Contingencies

#### Environmental Remediation Liabilities

For a discussion of environmental remediation liabilities, see Note 10, "Commitments and Contingencies" of the Notes to the Condensed Consolidated Financial Statements, which discussion is incorporated herein by reference.

#### Other Matters

From time to time, we are a party to or otherwise involved in legal proceedings, claims and government inspections or investigations and other legal matters both inside and outside the United States, arising in the ordinary course of our business or otherwise. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. See Note 10, "Commitments and Contingencies" of the Notes to the Condensed Consolidated Financial Statements, which discussion is incorporated herein by reference.

### Off-Balance Sheet Arrangements

In conjunction with the sale of our products in the ordinary course of business, we provide standard indemnification of business partners and customers for losses suffered or incurred for property damages, death and injury and for patent, copyright or any other intellectual property infringement claims by any third parties with respect to our products. The terms of these indemnification arrangements are generally perpetual. Except for losses related to property damages, the maximum potential amount of future payments we could be required to make under these arrangements is unlimited. As of June 29, 2018, we have not incurred any significant costs since the spin-off of Varian, Inc. and Varian Semiconductor Equipment Associates, Inc. in 1999 or the Distribution to defend lawsuits or settle claims related to these indemnification arrangements. As a result, we believe the estimated fair value of these arrangements is minimal.

We have entered into indemnification agreements with our directors and officers and certain of our employees that serve as officers or directors of our foreign subsidiaries that may require us to indemnify our directors and officers and

those certain

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employees against liabilities that may arise by reason of their status or service as directors or officers, and to advance their expenses incurred as a result of any legal proceeding against them as to which they could be indemnified.

Recent Accounting Standards or Updates Not Yet Effective

See Note 1, "Summary of Significant Accounting Policies" of the Notes to the Condensed Consolidated Financial Statements for a description of recent accounting standards, including the expected dates of adoption and the estimated effects on our consolidated financial statements.

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

We are exposed to three primary types of market risks: credit risk and counterparty risk, foreign currency exchange rate risk and interest rate risk.

#### Credit Risk and Counterparty Risk

We are exposed to credit loss in the event of nonperformance by counterparties on the foreign currency forward contracts used in hedging activities. These counterparties are large international and regional financial institutions and to date, no such counterparty has failed to meet its financial obligation to us under such contracts.

We are also exposed to credit loss in the event of default by counterparties of our financing receivables and our loans to VPT customers such as:

As of June 29, 2018, the Term Loan with CPTC was \$53.5 million. The \$53.5 million is composed of four Tranches: Tranche A of \$2.0 million, Tranche B of \$7.2 million, Tranche C of \$15.6 million, and Tranche D of \$28.7 million. All of the Tranches accrue paid-in-kind interest at 7.5% per annum, except the Tranche B which accrues paid-in-kind interest at 10% per annum. The maturity date of the Term Loan is December 2020. The Term Loan is secured by the assets of CPTC.

In addition, the Lenders have committed to lend up to \$15.0 million in Revolving Loans. Our share of the funding commitment from the Revolving Loan is \$7.2 million and as of June 29, 2018, we have funded \$3.1 million. The Revolving Loan accrues paid-in-kind interest at 10% per annum and has a maturity date of December 2018.

The seniority of these loans is as follows: Revolving Loan, Tranche A, Tranche B, Tranche C and Tranche D. If CPTC is in default, the interest on Tranche A, C and D will increase to 9.5% and the interest on Tranche B and the Revolving Loan will increase to 12.0%.

In May 2015, we committed to loan \$35.0 million to the Maryland Proton Treatment Center ("MPTC"). Our subordinated loan is due, with accrued interest, in three annual payments from 2020 to 2022. The interest on the outstanding loan accrues at 12%. In the three and nine months ended June 29, 2018, we recorded impairment charges of \$11.0 million and \$22.1 million, respectively, on our MPTC subordinated loan, which included accrued interest, due to the expected difference in value between the loan currently held by us and the value of the security to be issued to us in exchange as part of the refinancing expected in the fourth quarter of fiscal year 2018. As of June 29, 2018, the MPTC subordinated loan totaled, \$22.9 million. We also have \$25.0 million as short-term notes receivable related to a deferred payment arrangement with MPTC. The notes receivable carries an interest rate of 15% and is due on September 30, 2018.

We also have loans, including accrued interest, associated with the New York Proton Center, and Proton International LLC totaling \$27.1 million and \$1.6 million, respectively.

In July 2017, we purchased the outstanding senior secured debt related to the Rinecker Proton Therapy Center ("RPTC") in Munich, Germany for 21.5 million Euros or \$24.5 million. By purchasing the senior secured debt, we have a right to 89 million Euros in claims against all of RPTC's assets. In September 2017, the management of RPTC filed for bankruptcy in Germany. In January 2018, the final insolvency proceedings commenced and we expect the insolvency proceedings to be finalized within the next twelve months. Upon finalization of bankruptcy proceedings, we believe it is probable we will recover the outstanding senior secured debt balance and net trade accounts receivable.

See Note 16, "VPT Loans and Investment" of the Notes to the Condensed Consolidated Financial Statements for further information on loans to VPT customers.

In addition, cash and cash equivalents held with financial institutions may exceed the Federal Deposit Insurance Corporation insurance limits or similar limits in foreign jurisdictions. We also may need to rely on our credit facilities as described below under “Interest Rate Risk.” Our access to our cash and cash equivalents or ability to borrow could be reduced if one or more financial institutions with which we have deposits or from which we borrow should fail or otherwise be adversely impacted by conditions in the financial or credit markets. Conditions such as those we experienced as a result of the last economic downturn and accompanying contraction in the credit markets heighten these risks. Concerns over economic instability could make it more difficult for us to collect outstanding receivables and could adversely impact our liquidity.

#### Foreign Currency Exchange Rate Risk

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

We have many transactions denominated in foreign currencies and address certain of those financial exposures through a risk management program that includes the use of derivative financial instruments. We sell products throughout the world, often in the currency of the customer’s country, and may hedge certain of these larger foreign currency sale transactions when they are not transacted in the subsidiaries’ functional currency or in U.S. Dollars. The foreign currency transactions that fit our risk management policy criteria are hedged with foreign currency forward contracts. We may use other derivative instruments in the future. We enter into foreign currency forward contracts primarily to reduce the effects of fluctuating foreign currency exchange rates. We do not enter into foreign currency forward contracts for speculative or trading purposes. The forward contracts range from one to thirteen months in maturity.

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

The notional values of our sold and purchased foreign currency forward contracts outstanding as of June 29, 2018 were \$431.7 million and \$48.6 million, respectively. The notional amounts of foreign currency forward contracts are not a measure of our exposure. The fair value of forward contracts generally reflects the estimated amounts that we would receive or pay to terminate the contracts at the reporting date, thereby taking into account and approximating the current unrealized and realized gains or losses of the open contracts. A move in foreign currency exchange rates would change the fair value of the contracts, and the fair value of the underlying exposures hedged by the contracts would change in a similar offsetting manner.

In addition to our foreign currency forward contracts mentioned above, in February 2018, we entered into foreign currency forward contracts and a foreign currency option contract to economically hedge the foreign currency exchange rate risk on the consideration to be paid for the anticipated Sirtex acquisition. The foreign currency forward contracts allowed us to purchase a notional amount of A\$793.0 million for \$621.0 million on May 25, 2018. On May 25, 2018, we purchased the off-setting foreign currency forward contracts for a notional amount of \$596.8 million. Also in February 2018, we paid a premium of \$5.5 million for a foreign currency option that allowed us to purchase a notional amount of A\$792.0 million for \$641.5 million which expired on May 23, 2018. Since we did not acquire Sirtex, the foreign currency option was not exercised.

The foreign currency forward contracts and option contract did not qualify for hedge accounting. As such, changes in the fair value were recognized in acquisition-related expenses on the Condensed Consolidated Statements of Earnings. In the three and nine months ended June 29, 2018, we recorded losses of \$12.8 million and \$24.2 million, respectively, on the foreign currency forward contracts and \$0.5 million and \$5.5 million, respectively, on the foreign currency option contract.

#### Interest Rate Risk

Our market risk exposure to changes in interest rates depends primarily on our investment portfolio and borrowings. Our investment portfolio primarily consisted of cash and cash equivalents and available-for-sale investments as of June 29, 2018. The principal amount of cash and cash equivalents in continuing operations at June 29, 2018 totaled

\$536.0 million with a weighted average interest rate of 0.77%. Cash and cash equivalents at June 29, 2018 include \$155.8 million of money market funds with a weighted average interest rate of 1.84%.

At June 29, 2018, our available-for-sale investments, which include accrued interest, are the \$6.3 million in Subordinate Revenue Bonds with an interest rate to finance the Alabama Proton Therapy Center ("APTC") and the \$4.6 million in Senior Capital Appreciation Bonds to finance the Georgia Proton Treatment Center ("GPTC"). The APTC Subordinate Revenue bear

an interest rate of 8.5% per annum and the GPTC Senior Capital Appreciation Bonds bear an interest rate of 8.0% per annum. Our available-for-sale investments are carried at fair value.

Borrowings under the 2018 Revolving Credit Facility accrue interest at either (i) based on the Eurodollar Rate plus a margin of 1.000% to 1.375% based on a leverage ratio involving funded indebtedness and EBITDA, or (ii) based upon a base rate of (a) the federal funds rate plus 0.50%, (b) BofA's announced prime rate, or (c) the Eurodollar Rate plus 1.00%, whichever is highest, plus a margin of 0.000% to 0.375% based on the same leverage ratio, depending upon instructions from the Company. Borrowings under the 2018 Revolving Credit Facility have a contract repayment date of twelve months, or less, and a final maturity of five years if based on the Eurodollar Rate and all overnight borrowings on the base rate would also have a final maturity of five years.

We are affected by market risk exposure primarily through the effect of changes in interest rates on amounts payable under our 2018 Revolving Credit Facility. As of June 29, 2018, we did not have any short-term borrowings under the 2018 Revolving Credit Facility. See Note 8, "Borrowings" of the condensed consolidated financial statements for a discussion regarding the 2018 Credit Facility.

In addition, the Sumitomo Credit Facility allows VMS KK to borrow up to a maximum amount of 3.0 billion Japanese Yen. Borrowings under the Sumitomo Credit Facility accrue interest based on the basic loan rate announced by the Bank of Japan plus a margin of 0.5% per annum. As of June 29, 2018, we had an outstanding balance of \$18.2 million with a weighted average interest rate of 0.53% under the Sumitomo Credit Facility.

To date, we have not used derivative financial instruments to hedge the interest rate within our investment portfolio, borrowings, but may consider the use of derivative instruments in the future. In addition, although payments under certain of our operating leases for our facilities are tied to market indices, these operating leases do not expose us to material interest rate risk.

#### Item 4. Controls and Procedures

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

Changes in internal control over financial reporting. There were no changes in our internal control over financial (b) reporting that occurred during the third quarter of fiscal year 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II

### OTHER INFORMATION

#### Item 1. Legal Proceedings

We are subject to various legal proceedings and claims that are discussed in Note 10, "Commitments and Contingencies" to the Condensed Consolidated Financial Statements, which discussion is incorporated by reference into this item.

#### Item 1A. Risk Factors

There were no material changes during the period covered in this report to the risk factors previously disclosed in Part I, Item 1A, of our 2017 Annual Report on Form 10-K and Part II, Item 1A, of our Quarterly Report on Form 10-Q for the quarter ended December 29, 2017 and the quarter ended March 30, 2018, except as follows:



Potential tariffs or a global trade war could increase the cost of our products.

Potential tariffs imposed by the United States and China that include Varian technology could increase the cost of our products. These potential increased costs could adversely impact the competitiveness of our products and our operational results in the future.

On July 6, 2018, the Administration imposed 25% tariffs on a variety of imports from China, including Varian radiotherapy systems manufactured in China and certain components we import into the U.S. for our manufacturing and service activities. In addition to conversations with the Administration, we are also participating in the Office of the U.S. Trade Representative (USTR) process to consider product-specific exclusions from these tariffs. While we are uncertain of the outcome of these exclusion discussions, if we are successful, certain Varian products could be provided retroactive relief from these tariffs to the date of their enactment.

The Administration has also proposed two additional lists of products from China on which to impose tariffs; the first of these proposed lists involves 25% tariffs and the second involves 10% tariffs. We expect our imports into the U.S. to be impacted less by these two proposed tariff lists than the tariff list that was already imposed. It is not known if, or when, these subsequent rounds of tariffs would be imposed.

China has responded to the new and proposed U.S. tariffs by announcing two lists of products from the U.S. that are or, may in the future, be subject to new tariffs upon import to China. One round of Chinese retaliatory tariffs went into effect on July 6, 2018. Our products are not impacted by these tariffs. Our exports to China are, however, impacted by the second Chinese list, which has not taken effect yet. If either, or both, countries definitively impose additional tariffs on our parts or products, that could increase our costs and/or sales prices, potentially decrease the demand for these products and have a material effect on our business and operational results.

Our efforts to integrate acquisitions may not be successful, and this may adversely affect our financial results.

As part of our strategy to develop and identify new technologies, products and services, we may continue to acquire new businesses and technologies. Our integration of the operations of acquired businesses requires significant efforts, including the coordination of information technologies, research and development, sales and marketing, operations, manufacturing and finance. Success of an acquisition may depend, in part, on our ability to successfully integrate the operations of the acquired business. If such integration efforts are not successful, the anticipated benefits and synergies of the acquisition may not be realized fully or at all, or may take longer to realize than expected. Our efforts to successfully integrate acquisitions may also result in additional expenses and divert significant amounts of management's time from other projects.

Our failure to manage successfully and coordinate the growth of acquired businesses could also have an adverse impact on our business. In addition, there is no guarantee that some of the businesses we acquire will become profitable or remain so. If our acquisitions do not meet our initial expectations, we may record impairment charges.

Factors that will affect the success of our acquisitions include:

- our ability to retain key employees of the acquired businesses;
- the performance of the acquired businesses and their technologies, products or services;
- our ability to integrate the operations, financial and other systems of the acquired businesses;
- the ability of the combined company to achieve synergies among its constituent companies, such as increasing sales of the combined company's products and services, achieving expected cost savings and effectively combining technologies to develop new products and services;
- any disruption in order fulfillment or loss of sales due to integration processes;
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the presence or absence of adequate internal controls and/or significant fraud in the financial systems of the acquired businesses;

- any decrease in customer and distributor loyalty and product orders caused by dissatisfaction with the product lines and sales and marketing practices of the acquired businesses, including price increases; and
- our assumption of known contingent liabilities, known liabilities that prove greater than anticipated, or unknown liabilities that come to light, in each case to the extent that the realization of such liabilities increases our expenses or adversely affects our business or financial position.

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

(a) Not applicable

(b) Not applicable

(c) The following table provides information with respect to the shares of common stock repurchased by us during the third quarter of fiscal year 2018 (in millions, except per share amounts):

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(1)</sup>
March 31, 2018 - April 27, 2018	0.3	\$ 120.59	0.3	4.1
April 28, 2018 - May 25, 2018	—	\$ —	—	4.1
May 26, 2018 - June 29, 2018	—	\$ —	—	4.1
Total	0.3	\$ 120.59	0.3	4.1

In November 2016, the VMS Board of Directors authorized the repurchase of an additional 8.0 million shares of VMS common stock commencing on January 1, 2017. Share repurchases may be made in the open market, in <sup>(1)</sup> privately negotiated transactions (including accelerated share repurchase programs), or under Rule 10b5-1 share repurchase plans, and also may be made from time to time or in one or more larger blocks. All shares that were repurchased under the Company's share repurchase programs have been retired.

The preceding table excludes an immaterial number of shares of VMS common stock that were withheld by VMS in satisfaction of tax withholding obligations upon the vesting of restricted stock units granted under our employee stock plans.

## Item 3. Defaults Upon Senior Securities

None.

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 5. Other Information

None.



Item 6. Exhibits

The exhibits listed below are filed or incorporated by reference as part of this Form 10-Q:

Exhibit No.	Description
10.1	<u>Credit Agreement, dated as of April 3, 2018, among the Registrant, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer and each lender from time to time party thereto (incorporated by reference to Exhibit No. 10.1 to the Registrant's Form 8-K Current Report filed as of April 4, 2018, File No. 1-7598).</u>
15.1*	<u>Letter Regarding Unaudited Interim Financial Information.</u>
31.1*	<u>Chief Executive Officer Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act.</u>
31.2*	<u>Chief Financial Officer Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act.</u>
32.1**	<u>Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.2**	<u>Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed herewith

\*\* Furnished, not filed

SIGNATURES

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

VARIAN MEDICAL SYSTEMS, INC.  
(Registrant)

Dated: August 7, 2018 By: /s/ GARY E. BISCHOPING JR.

Gary E. Bischooping Jr.  
Senior Vice President and  
Chief Financial Officer  
(Duly Authorized Officer and  
Principal Financial Officer)