

ACCURAY INC
Form 10-Q
February 06, 2015
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2014

or

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

For the transition period from to

Commission File Number: 001-33301

ACCURAY INCORPORATED

(Exact Name of Registrant as Specified in Its Charter)

Edgar Filing: ACCURAY INC - Form 10-Q

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

20-8370041

(IRS Employer Identification Number)

1310 Chesapeake Terrace

Sunnyvale, California 94089

(Address of Principal Executive Offices Including Zip Code)

(408) 716-4600

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of January 30, 2015, there were 78,489,378 shares of the Registrant's Common Stock, par value \$0.001 per share, outstanding.

Table of Contents

Accuray Incorporated

Form 10-Q for the Quarter Ended December 31, 2014

Table of Contents

	Page No.
<u>PART I. Financial Information</u>	3
<u>Item 1. Unaudited Condensed Consolidated Financial Statements:</u>	3
<u>Condensed Consolidated Balance Sheets as of December 31, 2014 and June 30, 2014</u>	3
<u>Condensed Consolidated Statements of Operations and Comprehensive Loss for the three and six months ended December 31, 2014 and 2013</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the six months ended December 31, 2014 and 2013</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	24
<u>Item 4. Controls and Procedures</u>	25
<u>PART II. Other Information</u>	26
<u>Item 1. Legal Proceedings</u>	26
<u>Item 1A. Risk Factors</u>	26
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	30
<u>Item 3. Defaults Upon Senior Securities</u>	30
<u>Item 4. Mine Safety Disclosures</u>	30
<u>Item 5. Other Information</u>	30
<u>Item 6. Exhibits</u>	30
<u>Signatures</u>	31

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

(in thousands, except share amounts and par value)

(Unaudited)

	December 31, 2014	June 30, 2014 (1)
Assets		
Current assets:		
Cash and cash equivalents	\$ 97,273	\$ 92,346
Short-term investments	53,517	79,553
Restricted cash	1,436	1,492
Accounts receivable, net of allowance for doubtful accounts of \$837 and \$976 as of December 31, 2014 and June 30, 2014, respectively	62,987	72,152
Inventories	104,490	87,752
Prepaid expenses and other current assets	15,076	17,873
Deferred cost of revenue	11,960	13,302
Total current assets	346,739	364,470
Property and equipment, net	30,830	34,391
Goodwill	58,015	58,091
Intangible assets, net	19,541	23,517
Deferred cost of revenue	2,220	2,899
Other assets	10,220	11,820
Total assets	\$ 467,565	\$ 495,188
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	\$ 15,980	\$ 15,639
Accrued compensation	19,482	32,569
Other accrued liabilities	24,478	24,464
Customer advances	19,673	19,804
Deferred revenue	92,495	92,093
Total current liabilities	172,108	184,569
Long-term liabilities:		
Long-term other liabilities	10,483	6,593
Deferred revenue	9,875	9,866
Long-term debt	199,152	195,612
Total liabilities	391,618	396,640
Commitment and contingencies (Note 5)		
Stockholders Equity:		
Preferred stock, \$0.001 par value; authorized: 5,000,000 shares; no shares issued and outstanding		

Edgar Filing: ACCURAY INC - Form 10-Q

Common stock, \$0.001 par value; authorized: 200,000,000 shares as of December 31, 2014 and June 30, 2014 respectively; issued and outstanding: 78,438,490 and 77,178,365 shares at December 31, 2014 and June 30, 2014, respectively	78	77
Additional paid-in capital	461,995	451,750
Accumulated other comprehensive income	610	1,815
Accumulated deficit	(386,736)	(355,094)
Total stockholders' equity	75,947	98,548
Total liabilities and stockholders' equity	\$ 467,565	\$ 495,188

(1) The condensed consolidated balance sheet at June 30, 2014 has been derived from audited consolidated financial statements.

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

Table of Contents**Accuray Incorporated****Condensed Consolidated Statements of Operations and Comprehensive Loss**

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended December		Six Months Ended December	
	2014	2013	2014	2013
Net revenue:				
Products	\$ 47,650	\$ 45,148	\$ 80,665	\$ 74,716
Services	50,505	48,486	99,871	95,559
Total net revenue	98,155	93,634	180,536	170,275
Cost of revenue:				
Cost of products	27,171	24,980	47,836	43,581
Cost of services	32,495	30,483	66,410	62,045
Total cost of revenue	59,666	55,463	114,246	105,626
Gross profit	38,489	38,171	66,290	64,649
Operating expenses:				
Research and development	13,917	13,435	28,066	26,385
Selling and marketing	15,802	14,262	33,776	28,716
General and administrative	12,361	11,190	23,311	22,550
Total operating expenses	42,080	38,887	85,153	77,651
Loss from operations	(3,591)	(716)	(18,863)	(13,002)
Other expense, net	(5,528)	(3,775)	(10,989)	(6,235)
Loss before provision for income taxes	(9,119)	(4,491)	(29,852)	(19,237)
Provision for income taxes	873	950	1,790	1,737
Net loss	\$ (9,992)	\$ (5,441)	\$ (31,642)	\$ (20,974)
Net loss per share basic and diluted	\$ (0.13)	\$ (0.07)	\$ (0.41)	\$ (0.28)
Weighted average common shares used in computing loss per share				
Basic and diluted	77,924	75,280	77,607	74,990
Net loss	\$ (9,992)	\$ (5,441)	\$ (31,642)	\$ (20,974)
Foreign currency translation adjustment	(624)	58	(1,066)	223
Unrealized gain (loss) on investments, net of tax	2	69	(139)	359
Comprehensive loss	\$ (10,614)	\$ (5,314)	\$ (32,847)	\$ (20,392)

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

Table of Contents**Accuray Incorporated****Condensed Consolidated Statements of Cash Flows**

(in thousands)

(Unaudited)

	Six Months Ended December 31,	
	2014	2013
Cash Flows From Operating Activities		
Net loss	\$ (31,642)	\$ (20,974)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	9,960	10,576
Share-based compensation	7,127	4,983
Amortization of debt issuance costs	732	692
Amortization and accretion of discount and premium on investments	488	930
Accretion of interest on long-term debt	3,540	2,314
Recovery of bad debt, net	(51)	(244)
Provision for write-down of inventories	747	1,482
Changes in assets and liabilities:		
Restricted cash		(169)
Accounts receivable	6,619	(16,924)
Inventories	(18,628)	(7,709)
Prepaid expenses and other assets	2,750	(648)
Deferred cost of revenue	1,933	(3,502)
Accounts payable	1,313	(905)
Accrued liabilities	(3,050)	6,513
Customer advances	732	3,158
Deferred revenue	4,445	7,517
Net cash used in operating activities	(12,985)	(12,910)
Cash Flows From Investing Activities		
Purchases of property and equipment, net	(4,170)	(6,899)
Purchases of investments	(56,011)	(11,517)
Sales and maturities of investments	81,420	22,829
Net cash provided by investing activities	21,239	4,413
Cash Flows From Financing Activities		
Proceeds from employee stock plans	3,034	4,063
Taxes paid related to net share settlement of equity awards	(394)	(199)
Net cash provided by financing activities	2,640	3,864
Effect of exchange rate changes on cash and cash equivalents	(5,967)	1,767
Net increase (decrease) in cash and cash equivalents	4,927	(2,866)
Cash and cash equivalents at beginning of period	92,346	73,313
Cash and cash equivalents at end of period	\$ 97,273	\$ 70,447

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

Table of Contents

Accuray Incorporated

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Summary of Significant Accounting Policies

Description of Business

Accuray Incorporated (together with its subsidiaries, the Company or Accuray) is incorporated in Delaware. The Company designs, develops and sells advanced radiosurgery and radiation therapy systems for the treatment of tumors throughout the body. The Company conducts its business worldwide. The Company has its headquarters in Sunnyvale, California, with additional locations worldwide.

Basis of Presentation and Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company transactions and balances have been eliminated in consolidation.

The accompanying condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (GAAP), pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). Certain information and note disclosures have been condensed or omitted pursuant to such rules and regulations. The unaudited condensed consolidated financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary for a fair presentation of the periods presented. The results for the three and six months ended December 31, 2014 are not necessarily indicative of the results to be expected for the year ending June 30, 2015, for any other interim period or for any future year.

These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and accompanying notes for the year ended June 30, 2014 included in the Company's Annual Report on Form 10-K filed with the SEC. The Company's significant accounting policies are described in Note 2 to those audited consolidated financial statements.

Recent Accounting Standard Update Not Yet Effective

Edgar Filing: ACCURAY INC - Form 10-Q

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers: Topic 606* (ASU 2014-09), to supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. ASU 2014-09 is effective for the Company in its first quarter of fiscal 2018 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (ii) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined per ASU 2014-09. The Company has not yet selected a transition method and is currently evaluating the impact of pending adoption of ASU 2014-09 on its consolidated financial statements and related disclosures.

Use of Estimates

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

Concentration of Credit and Other Risks

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

Table of Contents

For the three and six months ended December 31, 2014 and 2013, there were no customers that represented 10% or more of total net revenue. At December 31, 2014, one customer accounted for 10% of the Company's total accounts receivable. At June 30, 2014, one customer accounted for 13% of accounts receivable.

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

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

Revenue Recognition

The Company earns revenue from the sale of products and related services. The Company records its revenues net of any value added or sales tax. For arrangements with multiple elements, the Company allocates arrangement fees to product and services based upon Vendor Specific Objective Evidence (VSOE) of fair value of the respective elements, Third-Party Evidence (TPE), or Best Estimate of Selling Price (BESP), using the relative selling price method.

Product and Service Revenue

The majority of product revenue is generated from sales of CyberKnife and TomoTherapy systems. If the Company is responsible for installation, the Company recognizes revenue after installation and acceptance of the system. Otherwise, revenue is recognized upon delivery, assuming all other revenue recognition criteria are met.

The Company offers its systems with post-contract customer support (PCS) contracts, installation services, training, and professional services. PCS contracts provide planned and corrective maintenance services, software updates, bug fixes, as well as call-center support. Service revenue is generated primarily from PCS (warranty period services and post warranty services), installation services, training, parts and upgrades that are sold under service contracts, and professional services. PCS revenue is deferred and recognized over the service period. Installation service revenue is recognized concurrent with system revenue. Training and professional service revenues that are not deemed essential to the functionality of the systems are recognized as such services are performed.

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

Net Loss Per Common Share

Basic and diluted net loss per share is computed by dividing net loss attributable to stockholders by the weighted average number of common shares outstanding during the period.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Numerator:				
Net loss used in computing net loss per share	\$ (9,992)	\$ (5,441)	\$ (31,642)	\$ (20,974)
Denominator:				
Weighted average shares used in computing basic and diluted loss per share	77,924	75,280	77,607	74,990

Table of Contents

The potentially dilutive shares of the Company's common stock resulting from the assumed exercise of outstanding stock options, the vesting of Restricted Stock Units (RSU), Market Stock Units (MSU) and Performance Stock Units (PSU), and the purchase of shares under the Employee Stock Purchase Program (ESPP), as determined under the treasury stock method, are excluded from the computation of diluted net loss per share because their effect would have been anti-dilutive. Additionally, the 3.75% Convertible Senior Notes due August 1, 2016 (the "3.75% Convertible Notes"), the 3.50% Convertible Senior Notes due February 1, 2018 (the "3.50% Convertible Notes") and the 3.50% Series A Convertible Notes (the "3.50% Series A Convertible Notes") due February 1, 2018 (together, the "Convertible Notes") are included in the calculation of diluted net income per share only if their inclusion is dilutive. For the three and six months ended December 31, 2014 and 2013, the potentially dilutive shares under the Convertible Notes were excluded from the calculation of diluted net loss per share as their inclusion would have been anti-dilutive. The following table sets forth all potentially dilutive securities excluded from the computation in the table above because their effect would have been anti-dilutive (in thousands):

	As of December 31,	
	2014	2013
Stock options	2,861	3,911
RSUs, PSUs and MSUs	5,069	4,263
3.75% Convertible Notes		
3.50% Convertible Notes	8,378	21,576
3.50% Series A Convertible Notes	3,886	
	20,194	29,750

Outstanding Convertible Notes Diluted Share Impact

The 3.75% Convertible Notes and 3.50% Series A Convertible Notes have an optional physical (share), cash or combination settlement feature and contain certain conditional conversion features. Due to the optional cash settlement feature and management's intent to settle the principal amount thereof in cash, the conversion shares underlying the outstanding principal amount of the 3.75% Convertible Notes and 3.50% Series A Convertible Notes, totaling approximately 10.6 million shares and 13.2 million shares, respectively, were not included in the potentially diluted share count table above. The Company's average stock price did not exceed the conversion price of the 3.75% Convertible Notes as of December 31, 2014 and 2013. The 3.9 million potentially dilutive shares of the 3.50% Series A Convertible Notes included in the table above represent the premium over the principal amount due to the higher average share price. The number of premium shares included in the Company's diluted share count will vary with fluctuations in the Company's share price. Higher actual share prices result in a greater number of premium shares.

Segment Information

The Company has determined that it operates in only one segment, as it only reports profit and loss information on an aggregate basis to its chief operating decision maker. Revenue by geographic region is based on the shipping addresses of the Company's customers. The following summarizes revenue by geographic region (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Americas	\$ 45,717	\$ 34,771	\$ 84,195	\$ 74,024
Europe, Middle East, India and Africa	26,094	34,135	57,031	52,901

Edgar Filing: ACCURAY INC - Form 10-Q

Asia (excluding Japan and India)	14,470	10,367	19,352	17,666
Japan	11,874	14,361	19,958	25,684
Total	\$ 98,155	\$ 93,634	\$ 180,536	\$ 170,275

Information regarding geographic areas in which the Company has long lived tangible assets is as follows (in thousands):

	December 31, 2014	June 30, 2014
Americas	\$ 27,184	\$ 30,542
Europe, Middle East, India and Africa	1,206	1,665
Asia (excluding Japan and India)	499	444
Japan	1,941	1,740
Total	\$ 30,830	\$ 34,391

Table of Contents**2. Balance Sheet Components****Financing receivables**

A financing receivable is a contractual right to receive money, on demand or on fixed or determinable dates, that is recognized as an asset in the Company's balance sheet. The Company's financing receivables, consisting of its accounts receivable with contractual maturities of more than one year, totaled \$2.3 million and \$2.8 million at December 31, 2014 and June 30, 2014, respectively and are included in Other Assets in the consolidated balance sheets. There was no balance in the allowance for doubtful accounts related to such financing receivables as of December 31, 2014 and June 30, 2014, respectively, as revenue is recognized on a cash basis for these receivables.

Inventories

Inventories consisted of the following (in thousands):

	December 31, 2014	June 30, 2014
Raw materials	\$ 44,539	\$ 37,003
Work-in-process	23,850	17,692
Finished goods	36,101	33,057
Inventories	\$ 104,490	\$ 87,752

Property and equipment, net

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

	December 31, 2014	June 30, 2014
Furniture and fixtures	\$ 5,306	\$ 5,351
Computer and office equipment	11,531	10,540
Software	10,827	10,736
Leasehold improvements	19,358	18,991
Machinery and equipment	47,715	45,730
Construction in progress	4,493	5,877
	99,230	97,225
Less: Accumulated depreciation	(68,400)	(62,834)
Property and equipment, net	\$ 30,830	\$ 34,391

Edgar Filing: ACCURAY INC - Form 10-Q

Depreciation expense related to property and equipment for the three and six months ended December 31, 2014 was \$3.0 million and \$6.0 million, respectively. Depreciation expense related to property and equipment for the three and six months ended December 31, 2013 was \$2.9 million and \$6.2 million, respectively.

3. Goodwill and Intangible Assets

Goodwill

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

	Six Months Ended December 31, 2014		Year Ended June 30, 2014
Balance at the beginning of the period	\$ 58,091	\$	59,368
Currency translation and other adjustments	(76)		(1,277)
Balance at the end of the period	\$ 58,015	\$	58,091

In the second quarter of fiscal 2015, the Company performed its annual goodwill impairment test. Based on this analysis, the Company determined that there was no impairment to goodwill. The Company will continue to monitor its recorded goodwill for indicators of impairment.

In connection with the acquisition of TomoTherapy in fiscal year 2011, the Company recognized liabilities related to unrecognized tax benefits as part of purchase accounting. During its first quarter of fiscal year 2014, the Company determined that certain of these liabilities related to unrecognized tax benefits were recorded in error. The Company evaluated the effects of this error

Edgar Filing: ACCURAY INC - Form 10-Q

Table of Contents

on the financial statements and concluded that the error was not material to any prior annual or interim periods or the current period. In September of 2013, the Company reduced goodwill and accrued liabilities by \$1.3 million to remove the liability recorded in error.

Intangible Assets

The Company's unamortized intangible assets associated with completed acquisitions at December 31, 2014 and June 30, 2014 are as follows (in thousands):

	Useful Lives (in years)	December 31, 2014			June 30, 2014		
		Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
Developed technology	5 - 6	\$ 46,747	\$ (27,206)	\$ 19,541	\$ 46,747	\$ (23,230)	\$ 23,517

The Company performs the annual impairment test in December of each year and did not identify any triggering events that would indicate potential impairment of its definite-lived intangible and long-lived assets as of December 31, 2014 and June 30, 2014.

Amortization expense related to intangible assets for the three and six months ended December 31, 2014 was \$2.0 million and \$4.0 million, respectively. Amortization expense related to intangible assets for the three and six months ended December 31, 2013 was \$2.2 million and \$4.4 million, respectively.

The estimated future amortization expense of purchased intangible assets as of December 31, 2014 is as follows (in thousands):

Year Ending June 30,	Amount
2015 (remaining 6 months)	\$ 3,977
2016	7,953
2017	7,568
2018	43
Thereafter	\$ 19,541

4. Financial Instruments

The Company considers all highly liquid investments held at major banks, certificates of deposit and other securities with original maturities of three months or less to be cash equivalents.

The Company classifies all of its investments as available-for-sale at the time of purchase because it is management's intent that these investments are available for current operations and includes these investments on its balance sheet as short-term investments. Investments with original maturities longer than three months include commercial paper, U.S. agency securities, non-U.S. government securities and investment-grade corporate debt securities. Investments classified as available-for-sale are recorded at fair market value with the related unrealized gains and losses included in accumulated other comprehensive income (loss), a component of stockholders' equity. Realized gains and losses are recorded based on specific identification of each security's cost basis.

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

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

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

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

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

Edgar Filing: ACCURAY INC - Form 10-Q

Table of Contents

The following tables summarize the amortized cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category for cash, cash equivalents and short-term investments (in thousands):

	December 31, 2014				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value	
				Cash and Cash Equivalents	Short-term Investments
Cash	\$ 81,166	\$	\$	\$ 81,166	\$
Level 1					
Money market funds	10,107			10,107	
	10,107			10,107	
Level 2					
Commercial paper	23,331		(1)	6,000	17,330
U.S. Agency securities	9,999		(10)		9,989
Non-U.S. government securities	3,074		(6)		3,068
Corporate notes	23,233		(103)		23,130
	59,637		(120)	6,000	53,517
Total	\$ 150,910	\$	\$ (120)	\$ 97,273	\$ 53,517

	June 30, 2014				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value	
				Cash and Cash Equivalents	Short-term Investments
Cash	\$ 91,797	\$	\$	\$ 91,797	\$
Level 1					
Money market funds	549			549	
Level 2					
Corporate notes	79,535	72	(54)		79,553
Total	\$ 171,881	\$ 72	\$ (54)	\$ 92,346	\$ 79,553

The Company's Level 2 investments in the table above are classified as Level 2 items because quoted prices in an active market are not readily accessible for those specific financial assets, or the Company may have relied on alternative pricing methods that do not rely exclusively on quoted prices to determine the fair value of the investments.

The Company had investments that were in an unrealized loss position as of December 31, 2014. The Company determined that (i) it does not have the intent to sell any of these investments and (ii) it is not likely that it will be required to sell any of these investments before recovery of the entire amortized cost basis. The Company reviews its investments quarterly to identify and evaluate investments that have an indication of possible impairment. As of December 31, 2014, the Company anticipates that it will recover the entire carrying value of such investments and has determined that no other-than-temporary impairments associated with credit losses were required to be recognized during the six months ended December 31, 2014.

Contractual maturities of available-for-sale securities at December 31, 2014 were as follows (in thousands):

Edgar Filing: ACCURAY INC - Form 10-Q

	December 31, 2014			
	Amortized		Fair Value	
	Cost			
Due in 1 year or less	\$	32,804	\$	32,768
Due in 1-2 years		15,453		15,401
Due in 2-3 years		5,380		5,348
	\$	53,637	\$	53,517

The following table summarizes the carrying values and estimated fair values of our long-term debt (in thousands):

	December 31, 2014				June 30, 2014			
	Carrying Value		Fair Value		Carrying Value		Fair Value	
3.75% Convertible Notes	\$	91,061	\$	104,460	\$	88,511	\$	115,415
3.50% Convertible Notes		44,654		68,294		44,654		79,388
3.50% Series A Convertible Notes		63,437		107,587		62,447		125,065
Total	\$	199,152	\$	280,341	\$	195,612	\$	319,868

Table of Contents

The long-term debt is measured on a non-recurring basis using Level 2 inputs based upon observable inputs of the Company's underlying stock price and the time value of the conversion option, since an observable quoted price of the Convertible Notes is not readily available.

5. Commitments and Contingencies

The Company's contractual obligations were presented in the Annual Report on Form 10-K for the previous annual reporting period ended June 30, 2014. There have been no material changes outside of the ordinary course of business in those obligations during the six months ended December 31, 2014.

Litigation

From time to time, the Company is involved in legal proceedings arising in the ordinary course of its business. The company records a provision for a loss when it believes that it is both probable that a loss has been incurred and the amount can be reasonably estimated. Currently, management believes the Company does not have any probable and estimable losses related to any current legal proceedings and claims. Although occasional adverse decisions or settlements may occur, except as described in the matters below, management does not believe that an adverse determination with respect to any of these claims would individually or in the aggregate materially and adversely affect the Company's financial condition or operating results. For certain legal proceedings, management believes that there is a reasonable possibility that material losses may be incurred; however, the Company is unable to reasonably estimate a range of reasonably possible losses with respect to these matters. Litigation is inherently unpredictable and is subject to significant uncertainties, some of which are beyond the Company's control. Should any of these estimates and assumptions change or prove to have been incorrect, the Company could incur significant charges related to legal matters that could have a material impact on its results of operations, financial position and cash flows.

Rotary Systems

On April 28, 2011, a former supplier to TomoTherapy, Rotary Systems Incorporated, filed suit in Minnesota state court, Tenth Judicial District, Anoka County, against TomoTherapy alleging misappropriation of trade secrets, as well as several other counts alleging various theories of injury. Rotary Systems alleges TomoTherapy misappropriated Rotary Systems' trade secrets pertaining to a component previously purchased from Rotary Systems, which component TomoTherapy now purchases from a different supplier. The suit alleges TomoTherapy improperly supplied the alleged trade secrets to its present supplier, Dynamic Sealing Technologies Inc. (also a named defendant in the suit). Rotary Systems has made an unspecified claim for damages of greater than \$50,000. TomoTherapy moved to dismiss the case and, on August 29, 2011, the court granted the motion to dismiss with respect to all counts other than the count alleging misappropriation of trade secrets. On May 21, 2012, the court gave Rotary Systems sixty days to identify the alleged trade secrets with specificity or face dismissal of its claim with prejudice. The court held a hearing on September 20, 2012 to review Rotary Systems' amended complaint. TomoTherapy filed a motion for summary judgment on the trade secret claim, the court ruled in favor of TomoTherapy on December 5, 2013, and Rotary Systems appealed. On December 22, 2014, the Minnesota Court of Appeals reversed the district court's dismissal of Rotary Systems' trade secrets claim and remanded it to the district court but affirmed the dismissal of Rotary Systems' other claims.

Sarif Biomedical Patent Litigation

On January 28, 2013, Sarif Biomedical filed a patent infringement complaint against the Company in the U.S. District Court for the District of Delaware. The complaint alleges the Company's CyberKnife System directly infringes U.S. Patent No. 5,755,725 and seeks unspecified monetary damages for the alleged infringement. Accuray filed an answer to the complaint in March 2013. The parties have exchanged initial discovery requests and responses. The court issued a scheduling order on April 29, 2014. Accuray made its first document production on May 30, 2014. On January 7, 2015, the parties entered into a written settlement agreement resolving the lawsuit. On January 13, 2015, the court entered an order dismissing the case and all claims with prejudice.

Cowealth Medical

On February 27, 2014, Cowealth Medical Holding Co., Ltd. (Cowealth), Accuray's former distributor in China, submitted a request for binding arbitration with the International Chamber of Commerce International Court of Arbitration (ICC) alleging, among other matters, that Accuray breached its distributor agreement with Cowealth by wrongfully terminating Cowealth as its distributor and misappropriated certain of Cowealth's confidential information. Cowealth is seeking damages of approximately \$161.0 million and injunctive relief. Accuray has filed counterclaims for damages of approximately \$35.0 million. Accuray's answer and counterclaim were submitted to the ICC on May 12, 2014, and Cowealth served its reply on June 27, 2014. A hearing was set for January 26, 2015 and is currently underway. Based on the information currently available to the Company, the Company expects the arbitrator to render a decision by the fourth quarter of fiscal 2015 or the first quarter of fiscal 2016. We are unable to predict the outcome of this lawsuit and therefore cannot determine the likelihood of loss nor estimate a range of possible loss.

Table of Contents**Software License Indemnity**

Under the terms of the Company's software license agreements with its customers, the Company agrees that in the event the software sold infringes upon any patent, copyright, trademark, or any other proprietary right of a third party, it will indemnify its customer licensees against any loss, expense, or liability from any damages that may be awarded against its customer. The Company includes this infringement indemnification in all of its software license agreements and selected managed services arrangements. In the event the customer cannot use the software or service due to infringement and the Company cannot obtain the right to use, replace or modify the license or service in a commercially feasible manner so that it no longer infringes, then the Company may terminate the license and provide the customer a refund of the fees paid by the customer for the infringing license or service. The Company has not recorded any liability associated with this indemnification, as it is not aware of any pending or threatened actions that represent probable losses as of December 31, 2014.

6. Share-Based Compensation

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

	Three Months Ended December 31,			Six Months Ended December 31,		
	2014	2013	2013	2014	2013	2013
Cost of revenue	\$ 560	\$ 469	\$ 955	\$ 923		
Research and development	804	656	1,698	1,134		
Selling and marketing	835	543	1,486	914		
General and administrative	1,655	1,135	2,988	2,012		
	\$ 3,854	\$ 2,803	\$ 7,127	\$ 4,983		

7. Debt*3.75% Convertible Senior Notes due August 2016*

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

Edgar Filing: ACCURAY INC - Form 10-Q

The 3.75% Convertible Notes were issued under an Indenture between the Company and The Bank of New York Mellon Trust Company, N.A., as trustee. Holders of the 3.75% Convertible Notes may convert their 3.75% Convertible Notes at any time on or after May 1, 2016 until the close of business on the business day immediately preceding the maturity date. Prior to May 1, 2016, holders of the 3.75% Convertible Notes may convert their 3.75% Convertible Notes only under the following circumstances: (1) during any calendar quarter after the calendar quarter ending September 30, 2011, and only during such calendar quarter, if the closing sale price of the Company's common stock for each of 20 or more trading days in the 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the conversion price in effect on the last trading day of the immediately preceding calendar quarter; (2) during the five consecutive business days immediately after any five consecutive trading-day period (such five consecutive trading-day period, the Note Measurement Period) in which the trading price per \$1,000 principal amount of 3.75% Convertible Notes for each trading day of that Note Measurement Period was equal to or less than 98% of the product of the closing sale price of shares of the Company's common stock and the applicable conversion rate for such trading day; (3) if the Company calls any or all of the 3.75% Convertible Notes for redemption, at any time prior to the close of business on the business day immediately preceding the redemption date; or (4) upon the occurrence of specified corporate transactions as described in the Indenture. Upon conversion by holders of the 3.75% Convertible Notes, the Company will have the right to pay or deliver, as the case may be, cash, shares of common stock of the Company or a combination thereof, at the Company's election. At any time on or prior to the 33rd business day immediately preceding the maturity date, the Company may irrevocably elect to (a) deliver solely shares of common stock of the Company in respect of the Company's conversion obligation or (b) pay cash up to the aggregate principal amount of the 3.75% Convertible Notes to be converted and pay or deliver, as the case may be, cash, shares of common stock of the Company or a combination thereof in respect of the remainder, if any, of the Company's conversion obligation in excess of the aggregate principal amount of the 3.75% Convertible Notes being converted. The initial conversion rate is 105.5548 shares of the Company's common stock per \$1,000 principal amount of 3.75% Convertible Notes (which represents an

Table of Contents

initial conversion price of approximately \$9.47 per share of the Company's common stock). The conversion rate, and thus the conversion price, are subject to adjustment as further described below.

Holders of the 3.75% Convertible Notes who convert their 3.75% Convertible Notes in connection with a make-whole fundamental change, as defined in the Indenture, may be entitled to a make-whole premium in the form of an increase in the conversion rate. Additionally, in the event of a fundamental change, as defined in the Indenture, holders of the 3.75% Convertible Notes may require the Company to purchase all or a portion of their 3.75% Convertible Notes at a fundamental change repurchase price equal to 100% of the principal amount of 3.75% Convertible Notes, plus accrued and unpaid interest, if any, to, but not including, the fundamental change repurchase date.

Prior to the maturity date, the Company may redeem for cash all or a portion of the 3.75% Convertible Notes if the closing sale price of its common stock exceeds 130% of the applicable conversion price (the initial conversion price is approximately \$9.47 per share of common stock) of such 3.75% Convertible Notes for at least 20 trading days during any consecutive 30 trading-day period (including the last trading day of such period).

In accordance with Accounting Standards Codification, or ASC 470-20, *Debt with Conversion and Other Options*, the Company separately accounts for the liability and equity conversion components of the 3.75% Convertible Notes. The principal amount of the liability component of the 3.75% Convertible Notes was \$75.9 million as of the date of issuance based on the present value of its cash flows using a discount rate of 10%, our approximate borrowing rate at the date of the issuance for a similar debt instrument without the conversion feature. The carrying value of the equity conversion component was \$24.1 million. A portion of the initial purchaser's discount and commission and the offering costs totaling \$0.9 million was allocated to the equity conversion component. The liability component is being accreted to the principal amount of the 3.75% Convertible Notes using the effective interest method over five years.

3.50% Convertible Senior Notes due February 2018

In February 2013, the Company issued \$115.0 million aggregate principal amount of its 3.50% Convertible Notes to certain QIBs. The 3.50% Convertible Notes were offered and sold to the QIBs pursuant to Rule 144A. The net proceeds from the offering, after deducting the initial purchaser's discount and commission and the related offering costs, were approximately \$110.5 million. The offering costs and the initial purchaser's discount and commission (which are recorded in Other Assets) are both being amortized to interest expense using the effective interest method over five years. The 3.50% Convertible Notes bear interest at a rate of 3.50% per year, payable semi-annually in arrears in cash on February 1 and August 1 of each year, which began on August 1, 2013. The 3.50% Convertible Notes will mature on February 1, 2018, unless earlier repurchased, redeemed or converted.

In April 2014, through a series of transactions, the Company refinanced approximately \$70.3 million aggregate principal amount of the 3.50% Convertible Notes with approximately \$70.3 million aggregate principal amount of the Company's new 3.50% Series A Convertible Senior Notes due 2018 (the 3.50% Series A Convertible Notes).

The 3.50% Convertible Notes were issued under an Indenture between the Company and The Bank of New York Mellon Trust Company, N.A., as trustee. Holders of the 3.50% Convertible Notes may convert their 3.50% Convertible Notes at any time until the close of business on the business day immediately preceding the maturity date. The 3.50% Convertible Notes are convertible, as described below into common stock of

Edgar Filing: ACCURAY INC - Form 10-Q

the Company at an initial conversion rate equal to 187.6877 shares of common stock per \$1,000 principal amount of the 3.50% Convertible Notes, which is equivalent to a conversion price of approximately \$5.33 per share of common stock, subject to adjustment.

Holders of the 3.50% Convertible Notes who convert their 3.50% Convertible Notes in connection with a make-whole fundamental change, as defined in the Indenture, may be entitled to a make-whole premium in the form of an increase in the conversion rate. Additionally, in the event of a fundamental change, as defined in the Indenture, holders of the 3.50% Convertible Notes may require the Company to purchase all or a portion of their 3.50% Convertible Notes at a fundamental change repurchase price equal to 100% of the principal amount of 3.50% Convertible Notes, plus accrued and unpaid interest, if any, to, but not including, the fundamental change repurchase date.

In accordance with guidance in ASC 470-20, *Debt with Conversion and Other Options* and ASC 815-15, *Embedded Derivatives*, the Company determined that the embedded conversion components of the 3.50% Convertible Note do not require bifurcation and separate accounting. The remaining \$44.7 million principal amount of the 3.50% Convertible Note has been recorded in Long-term Debt on the consolidated balance sheet as of December 31, 2014.

3.50% Series A Convertible Senior Notes due February 2018

On April 17, 2014, the Company entered into note exchange agreements with certain holders (the Participating Holders) of the 3.50% Convertible Notes to refinance approximately \$70.3 million aggregate principal amount of the 3.50% Convertible Notes with approximately \$70.3 million aggregate principal amount of the 3.50% Series A Convertible Notes. Pursuant to the note exchange agreements, the Company also paid the Participating Holders an aggregate of approximately \$0.4 million in cash in connection with

Table of Contents

such transactions. The principal amount of 3.50% Convertible Notes refinanced for each \$1,000 principal amount of the 3.50% Series A Convertible Notes was \$1,000 and the amount in cash paid per \$1,000 principal amount of such 3.50% Convertible Notes delivered was determined in individual negotiations between the Company and each Participating Holder. The Series A Convertible Notes have the same interest rate, maturity and other terms as the 3.50% Convertible Notes, except that the 3.50% Series A Convertible Notes are convertible into cash, shares of the Company's common stock or a combination of cash and shares of common stock, at the Company's option.

The 3.50% Series A Convertible Notes were issued under an Indenture between the Company and The Bank of New York Mellon Trust Company, N.A., as trustee. Holders of the 3.50% Series A Convertible Notes may convert their Securities at any time on or after November 1, 2017 until the close of business on the business day immediately preceding the maturity date. Prior to November 1, 2017, holders of the 3.50% Series A Convertible Notes may convert their Securities only under the following circumstances: (1) during any calendar quarter after the calendar quarter ending September 30, 2014, and only during such calendar quarter, if the closing sale price of the Company's common stock for each of 20 or more trading days in the 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the conversion price in effect on the last trading day of the immediately preceding calendar quarter; (2) during the five consecutive business days immediately after any five consecutive trading-day period (such five consecutive trading-day period, the Note Measurement Period) in which the trading price per \$1,000 principal amount of 3.50% Series A Convertible Notes for each trading day of that Securities Measurement Period was equal to or less than 98% of the product of the closing sale price of shares of the Company's common stock and the applicable conversion rate for such trading day; or (3) upon the occurrence of specified corporate transactions as described in the Indenture. Upon conversion by holders of the 3.50% Series A Convertible Notes, the Company will have the right to pay or deliver, as the case may be, cash, shares of common stock of the Company or a combination thereof, at the Company's election. At any time on or prior to the 17th business day immediately preceding the maturity date, the Company may irrevocably elect to (a) deliver solely shares of common stock of the Company in respect of the Company's conversion obligation or (b) pay cash up to the aggregate principal amount of the 3.50% Series A Convertible Notes to be converted and pay or deliver, as the case may be, cash, shares of common stock of the Company or a combination thereof in respect of the remainder, if any, of the Company's conversion obligation in excess of the aggregate principal amount of the 3.50% Series A Convertible Notes being converted. The initial conversion rate is 187.6877 shares of the Company's common stock per \$1,000 principal amount of 3.50% Series A Convertible Notes (which represents an initial conversion price of approximately \$5.33 per share of the Company's common stock). The conversion rate, and thus the conversion price, are subject to adjustment as further described below.

Holders of the 3.50% Series A Convertible Notes who convert their Notes in connection with a make-whole fundamental change, as defined in the Indenture, may be entitled to a make-whole premium in the form of an increase in the conversion rate. Additionally, in the event of a fundamental change, as defined in the Indenture, holders of the 3.50% Series A Convertible Notes may require the Company to purchase all or a portion of their 3.50% Convertible Notes at a fundamental change repurchase price equal to 100% of the principal amount of the 3.50% Series A Convertible Notes, plus accrued and unpaid interest, if any, to, but not including, the fundamental change repurchase date.

In accordance with Accounting Standards Codification, or ASC 470-20, *Debt with Conversion and Other Options*, the Company separately accounts for the liability and equity conversion components of the 3.50% Series A Convertible Notes. The principal amount of the liability component of the 3.50% Series A Convertible Notes was \$62.5 million as of the date of issuance based on the present value of its cash flows using a discount rate of 7%, our approximate borrowing rate at the date of the issuance for a similar debt instrument without the conversion feature. The carrying value of the equity conversion component was \$7.9 million. In addition, the portion of the cash amount paid to the Participating Holders totaling \$0.4 million was allocated to the debt discount with the remaining \$47,000 to the equity component. The liability component is being accreted to the principal amount of the 3.50% Series A Convertible Notes using the effective interest method through the maturity in February 2018.

The following table presents the carrying values of all Convertible Notes as of December 31, 2014 (in thousands):

Edgar Filing: ACCURAY INC - Form 10-Q

	3.75% Notes		3.50% Notes		3.50% Series A Notes		TOTAL
Carrying amount of the equity conversion component	\$	23,189	\$		\$	7,844	\$ 31,033
Principal amount of the Convertible Notes	\$	100,000	\$	44,654	\$	70,346	\$ 215,000
Unamortized debt discount		(8,939)				(6,909)	(15,848)
Net carrying amount	\$	91,061	\$	44,654	\$	63,437	\$ 199,152

Table of Contents

A summary of interest expense on all Convertible Notes is as follows (in thousands):

	Three months ended December 31,		Six months ended December 31,	
	2014	2013	2014	2013
Interest expense related to contractual interest coupon	\$ 1,943	\$ 1,944	\$ 3,886	\$ 3,888
Interest expense related to amortization of debt discount	1,782	1,166	3,541	2,314
Interest expense related to amortization of debt issuance costs	369	349	732	692
	\$ 4,094	\$ 3,459	\$ 8,159	\$ 6,894

8. Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income consist of net loss, unrealized gains and losses on available-for-sale investments, changes in foreign currency exchange rate translation and net changes related to defined benefit pension plan. The unrealized gains and losses on available-for-sale investments, changes in foreign currency exchange rate translation and net changes related to defined benefit pension plan are excluded from earnings and reported as a component of stockholders' equity. The foreign currency translation adjustment results from those subsidiaries not using the United States dollar as their functional currency since the majority of their economic activities are primarily denominated in their applicable local currency. Accordingly, all assets and liabilities related to these operations are translated at the current exchange rates at the end of each period. The resulting cumulative translation adjustments are recorded directly to the accumulated other comprehensive loss account in stockholders' equity. Revenues and expenses are translated at average exchange rates in effect during the period.

The components of accumulated other comprehensive income in the equity section of the balance sheets are as follows (in thousands):

	December 31, 2014	June 30, 2014
Net unrealized gain (loss) on short-term investments	\$ (121)	\$ 18
Cumulative foreign currency translation gain	1,298	2,364
Defined benefit pension obligation	(567)	(567)
Accumulated other comprehensive income	\$ 610	\$ 1,815

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

The following discussion and analysis of our financial condition as of December 31, 2014 and results of operations for the three and six months ended December 31, 2014 and 2013 should be read together with our condensed consolidated financial statements and related notes included elsewhere in this report. Statements made in this Form 10-Q report that are not statements of historical fact are forward-looking statements and are subject to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements in this report relate, but are not limited, to: our future results of operations and financial position, including the sufficiency of cash resources and expected cash flows to fund future operations, including the next 12 months; our backlog and expectations regarding age-outs and cancellations of contracts, the effects of our process improvements on age-outs, backlog and revenue; expected uses of cash during fiscal 2015; the anticipated

drivers of our future capital requirements; the anticipated successful introduction of the MLC for the CyberKnife Systems, the timing of its release and its impact on our business; our expectations regarding the factors that will impact sales, competitive positioning and long-term success for our CyberKnife and TomoTherapy Systems; our belief that TomoTherapy Systems offer clinicians and patients significant benefits over other radiation therapy systems in the market; the anticipated risks associated with our foreign operations and fluctuations in the U.S. dollar and foreign currencies as well as our ability to mitigate such risks; and our business strategy, plans and objectives. Forward-looking statements generally can be identified by words such as anticipates, believes, estimates, expects, intends, plans, predicts, projects, may, will be, will continue, will likely result, and similar expressions. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from expectations, including those risks discussed in this quarterly report, in particular under the heading Risk Factors in Part II, Item 1A as well as the risks detailed in Part I, Item 1A of the Company's annual report on Form 10-K for fiscal year 2014 and in Part II, Item 1A of the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2014 and other filings we make with the Securities and Exchange Commission. Forward-looking statements speak only as of the date the statements are made and are based on information available to the Company at the time those statements are made and/or management's good faith belief as of that time with respect to future events. The Company assumes no obligation to update forward-looking statements to reflect actual performance or results, changes in assumptions or changes in other factors affecting forward-looking information, except to the extent required by applicable securities laws. Accordingly, investors should not place undue reliance on any forward-looking statements.

Table of Contents

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

Overview

Products and Markets

Accuray Incorporated is a radiation oncology company that develops, manufactures, sells and supports precise, innovative treatment solutions. Our leading edge technologies are designed to deliver advanced radiation therapy including radiosurgery, stereotactic body radiation therapy, intensity modulated radiation therapy, image guided radiation therapy and adaptive radiation therapy tailored to the specific needs of each patient. Our suite of products includes the CyberKnife® Systems and the TomoTherapy® Systems. The systems are complementary offerings, optimized to serve separate patient populations treated by the same medical specialty, with advanced capabilities that offer increased treatment flexibility.

The CyberKnife Systems are robotic systems designed to deliver radiosurgery treatments to cancer tumors anywhere in the body. The CyberKnife Systems are the only dedicated, full body robotic radiosurgery systems on the market. Radiosurgery is an alternative to traditional surgery for tumors and is performed on an outpatient basis in one to five treatment sessions. It allows for the treatment of patients who otherwise would not be treated with radiation, who may not be good candidates for surgery, or who desire non-surgical treatments. The use of radiosurgery with CyberKnife Systems to treat tumors throughout the body has grown significantly in recent years, but currently represents only a small portion of the patients who develop tumors treatable with CyberKnife Systems. A determination of when it may or may not be appropriate to use a CyberKnife System for treatment is at the discretion of the treating physician and depends on the specific patient. However, given the CyberKnife Systems design to treat focal tumors, the CyberKnife Systems are generally not used to treat (1) very large tumors, which are considerably wider than the radiation beam that can be delivered by CyberKnife Systems, (2) diffuse wide-spread disease, as is often the case for late stage cancers, because they are not localized (though CyberKnife Systems might be used to treat a focal area of the disease) and (3) systemic disease, like leukemias and lymphomas, which are not localized to an organ, but rather involve cells throughout the body.

Our CyberKnife M6 Series Systems have the option of: fixed collimator, iris collimator, and/or multi-leaf collimator, or MLC. The initial supplier producing the MLC for our CyberKnife M6 Series Systems experienced low manufacturing yields and initially delivered only a small number of units. In addition, our initial life-cycle testing revealed that the MLC did not have the durability that we, and our customers, expect in our products. Subsequently, our internal testing of the MLC has been concluded to our satisfaction and we have begun our evaluation of the MLC in the field, with the goal of ensuring that we introduce a clinically effective and reliable collimator. The evaluation sites will follow into the treatment phase once their evaluation is complete which is expected to occur in the third quarter of fiscal 2015. While we are confident in our path forward, due to the complexity of the MLC, there is still some risk in this project that could cause further delays. In the meantime, and despite the delay in the launch of the MLC upgrade, we are continuing to book orders and install the CyberKnife M6 Series Systems with fixed and iris collimators. Additionally, we are working closely with our supply chain network and expect to begin manufacturing the first commercial MLC units in the third quarter of fiscal 2015 for shipment in the fourth quarter of fiscal 2015.

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

- Continued adoption of the CyberKnife M6 Series Systems;

Edgar Filing: ACCURAY INC - Form 10-Q

- Production and shipment of MLC that meets the standards that we, and our customers, expect in our products;
- Change in medical practice to utilize radiosurgery more regularly as an alternative to surgery or other treatments;
- Greater awareness among doctors and patients of the benefits of radiosurgery with CyberKnife Systems;
- Continued evolution in clinical studies demonstrating the safety, efficacy and other benefits of using CyberKnife Systems to treat tumors in various parts of the body;
- Continued advances in technology that improve the quality of treatments and ease of use of CyberKnife Systems;
- Improved access to radiosurgery with CyberKnife Systems in various countries through regulatory approvals;
- Medical insurance reimbursement policies that cover CyberKnife System treatments; and
- Expansion of sales of CyberKnife Systems in countries throughout the world.

The TomoTherapy Systems are advanced, fully integrated and versatile radiation therapy systems for the treatment of a wide range of cancer types. TomoTherapy H Series Systems come in configurations of TomoHTM, TomoHDTM and TomoHDATM. Radiation therapy is used in a variety of ways, often to treat tissue surrounding a tumor area after surgical removal of the tumor and also as the primary treatment for tumors. Radiation therapy treatments impact both cancer cells as well as healthy tissue; therefore the

Table of Contents

total prescribed radiation dose is divided into many fractions and delivered in an average of 25 to 35 treatment sessions over several weeks. Radiation therapy has been widely available and used in developed countries for decades, though many developing countries do not currently have a sufficient number of radiation therapy systems to adequately treat their domestic cancer patient populations. The number of radiation therapy systems in use and sold each year is currently many times larger than the number of radiosurgery systems. We believe the TomoTherapy Systems offer clinicians and patients significant benefits over other radiation therapy systems in the market. We believe our ability to capture more sales will be influenced by a number of factors including the following:

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

Sale of Our Products

Generating revenue from the sale of our systems is a lengthy process. Selling our systems, from first contact with a potential customer to a signed sales contract that meets backlog criteria varies significantly and generally spans six months to two years. The time from receipt of a signed contract to revenue recognition is governed generally by the time required by the customer to build, renovate or prepare the treatment room for installation of the system.

In the United States, we primarily market directly to customers, including hospitals and stand-alone treatment facilities, through our sales organization and we also market to customers through sales agents and group purchasing organizations. Outside the United States, we market to customers directly and through distributors. We have sales and service offices in many countries in Europe, Japan and other countries in Asia, South America, and throughout the world.

Backlog

Edgar Filing: ACCURAY INC - Form 10-Q

We report backlog in the following manner:

- **Products:** Orders for systems and upgrades are reported in backlog, excluding amounts attributable to post-contractual-services (warranty period services and post warranty services or PCS), installation, training and professional services.
- **Service:** Orders for PCS, upgrades acquired through the upgrade rights included in our service contracts, installation services, training and professional services are not reported in backlog.

For orders that cover both products and services, only the portion of the order that will be recognized as product revenue is reported as backlog. The portion of the order that will be recognized as service revenue (for example, PCS) is not included in reported backlog. Product backlog totaled \$357.8 million as of December 31, 2014. This included \$44.5 million of orders for either CyberKnife M6 Systems configured with an MLC or orders for MLC units to upgrade existing installed CyberKnife M6 Systems. Additionally, \$29.2 million of CyberKnife orders which had previously been included in backlog were upgraded to the new platform (M6) in the current quarter. Product backlog totaled \$362.0 million as of December 31, 2013, and included \$32.2 million of orders for either new CyberKnife M6 systems configured with an MLC or orders for MLC units to upgrade existing installed CyberKnife M6 systems.

In order for the product portion of a CyberKnife or TomoTherapy System sales agreement to be counted as backlog, it must meet the following criteria:

- The contract is signed and properly executed by both the customer and us. A customer purchase order that is signed and incorporates the terms of our contract quote will be considered equivalent to a signed and executed contract;
- The contract is non-contingent - it either has cleared all its contingencies or contains no contingencies when signed;
- We have received a minimum deposit or a letter of credit; the sale is a direct channel sale to a government entity, or the product has shipped to a customer with credit sufficient to cover the minimum deposit;
- The specific end customer site has been identified by the customer in the written contract or written amendment;
- For orders in our Latin America region, we request supporting evidence that the end customer has commenced construction to place our products if the site does not already exist; and

Table of Contents

- Less than 2.5 years have passed since the contract met all the criteria above. If more than 2.5 years have passed since the contract has met all of the requirements above, it is considered aged-out and the revenue associated with the contract is removed from our backlog calculation.

Although our backlog includes only contractual agreements with our customers for the purchase of CyberKnife Systems or TomoTherapy Systems, we cannot provide assurance that we will convert backlog into recognized revenue due to factors outside our control. Our backlog is primarily impacted by three items: cancellations, age-outs and foreign currency fluctuations. Orders could be cancelled for reasons including, without limitation, changes in customers' needs or financial condition, changes in government or health insurance reimbursement policies, changes to regulatory requirements, or other reasons. In addition to cancellations, after 2.5 years, if we have not been able to recognize revenue on a contract, we remove the revenue associated with the contract from backlog and the order is considered aged out. Contracts may age out for many reasons, including inability of the customer to pay, inability of the customer to adapt their facilities to accommodate our products in a timely manner, inability to timely obtain licenses necessary for customer facilities or operation of our equipment among other reasons for delays. Our backlog also includes amounts not denominated in U.S. Dollars and therefore fluctuations in the U.S. Dollar compared to other currencies will impact backlog. Generally, strengthening in the U.S. Dollar will negatively impact backlog.

The below table is provided for comparison purposes only. Gross orders are defined as the sum of new orders recorded during the period adjusted for any revisions to existing orders during the period. Net product orders are defined as gross product orders less cancellations, age-outs and foreign exchange adjustments.

	Three months ended December 31,		Six months ended December 31,	
	2014	2013	2014	2013
Gross orders	\$ 72,261	\$ 80,294	\$ 131,024	\$ 143,692
Net orders	41,474	59,366	73,756	119,429
Order backlog at the end of the period	357,831	362,044	357,831	362,044

Gross orders decreased by \$8.0 million for the three months ended December 31, 2014 as compared to the three months ended December 31, 2013. Gross orders decreased by \$12.7 million for the six months ended December 31, 2014 as compared to the six months ended December 31, 2013. For both periods the total number of gross units ordered increased over prior period; however, the dollar value of orders was negatively impacted by product mix and foreign exchange currency fluctuations.

Net orders decreased by \$17.9 million for the three months ended December 31, 2014 as compared to the three months ended December 31, 2013. Net orders decreased by \$45.7 million for the six months ended December 31, 2014 as compared to the six months ended December 31, 2013. Over the previous two fiscal years we have made numerous changes to our order taking process, including increased oversight responsibility for and management of distributors and changes in timing as to when we enter some of our distributor orders to the backlog. We believe these changes will improve the quality of backlog over time and reduce the level of age-outs.

Age-outs were \$18.1 million and \$35.9 million in the three and six months ended December 31, 2014, respectively, in comparison to \$19.0 million and \$22.3 million in the three and six months ended December 31, 2013, respectively. Currently, we expect age-outs in the second half of this fiscal year to decline to a range of \$16.0 to \$25.0 million as compared to the \$35.9 million in age outs recorded during the first half of the fiscal year. Cancellations were \$6.9 million and \$9.5 million in the three and six months ended December 31, 2014, respectively, in comparison to \$1.9 million in the three and six months ended December 31, 2013, respectively. Cancellations are outside of our control and difficult to forecast; however, we continue to work closely with our customers to minimize this impact to our business. We believe, based on historical

Edgar Filing: ACCURAY INC - Form 10-Q

patterns, cancellations in the second half of fiscal 2015 will be more comparable to the fiscal 2014 numbers above than the first half of fiscal 2015 numbers. In addition order backlog was reduced due to foreign currency impacts by \$5.8 million and \$11.9 million in the three and six months ended December 31, 2014, respectively, in comparison to \$0.8 million and \$0.2 million in the three and six months ended December 31, 2013, respectively.

Table of Contents**Results of Operations Three and Six Months Ended December 31, 2014 and 2013**

(Dollars in thousands)	Three Months Ended December 31,					Six Months Ended December 31,				
	2014		2013		2014-2013	2014		2013		2014-2013
	Amount	% (a)	Amount	% (a)	% change	Amount	% (a)	Amount	% (a)	% change
Products	\$ 47,650	49%	\$ 45,148	48%	6%	\$ 80,665	45%	\$ 74,716	44%	8%
Services	50,505	51	48,486	52	4	99,871	55	95,559	56	5
Net revenue	\$ 98,155	100%	\$ 93,634	100%	5%	\$ 180,536	100%	\$ 170,275	100%	6%
Gross profit	\$ 38,489	39%	\$ 38,171	41%	1%	\$ 66,290	37%	\$ 64,649	38%	3%
Products gross profit	20,479	43	20,168	45	2	32,829	41	31,135	42	5
Services gross profit	18,010	36	18,003	37		33,461	34	33,514	35	
Research and development expenses	13,917	14	13,435	14	4	28,066	16	26,385	15	6
Selling and marketing expenses	15,802	16	14,262	15	11	33,776	19	28,716	17	18
General and administrative expenses	12,361	13	11,190	12	10	23,311	13	22,550	13	3
Other expense, net	5,528	6	3,775	4	46	10,989	6	6,235	4	76
Provision for income taxes	873	1	950	1	(8)	1,790	1	1,737	1	3
Net loss	\$ (9,992)	10%	\$ (5,441)	6%	84%	\$ (31,642)	18%	\$ (20,974)	12%	51%

(a) Expressed as a percentage of total net revenue, except for product and services gross profits which are expressed as a percentage of related product and services revenue.

Net Revenue

Sales of our products outside of the Americas region account for a significant portion of our total net revenue. Revenue derived from sales outside of the Americas region was \$52.4 million and \$58.9 million for the three months ended December 31, 2014 and 2013, respectively, and represented 53% and 63% of our net revenue during these periods. Revenue derived from sales outside of the Americas region was \$96.3 million for both the six months ended December 31, 2014 and 2013, respectively, and represented 53% and 57% of our net revenue during these periods.

Product Net Revenue. Product net revenue increased by \$2.5 million for the three months ended December 31, 2014 as compared to the three months ended December 31, 2013, primarily due to a higher average selling price due to product configuration mix.

Product net revenue increased by \$5.9 million for the six months ended December 31, 2014 as compared to the six months ended December 31, 2013, primarily due to a higher average selling price due to product configuration mix. In addition, product revenue upgrades increased by \$2.1 million in the six months ended December 31, 2014 as compared to the same period in fiscal 2014.

Services Net Revenue. Services net revenue increased by \$2.0 million and \$4.3 million for the three and six months ended December 31, 2014, respectively, as compared to the three and six months ended December 31, 2013, respectively. The increase in services net revenue was

primarily attributable to an increase in our installed base and an increase in the number of systems under our service contracts as compared to the same period in fiscal 2014.

Gross Profit

Overall gross profit for the three months ended December 31, 2014 increased \$0.3 million, or 1%, as compared to the three months ended December 31, 2013. The increase was primarily due to higher product revenues and product mix.

Product margin for the three months ended December 31, 2014 were negatively impacted by 2% primarily due to foreign exchange fluctuations. Services gross margin for the three months ended December 31, 2014 decreased by 2% primarily due to higher departmental expense related to increase in headcount to further focus on service excellence and customer satisfaction.

The overall gross profit for the six months ended December 31, 2014 increased by \$1.6 million, or 3% as compared to the six months ended December 31, 2013. Product margin decreased by 1% primarily due to the impact of foreign exchange fluctuations. Services gross margin for the six months ended December 31, 2014 decreased by 2% primarily due to the impact of changes in foreign exchange rates and field service personnel costs related to increase in headcount to further focus on service excellence and customer satisfaction.

Table of Contents

Research and Development

Research and development expenses were \$13.9 million in the three months ended December 31, 2014 as compared to \$13.4 million in the three months ended December 31, 2013, which represents an increase of \$0.5 million, or 4%. The increase was primarily due to \$0.4 million of additional headcount and IT related expenses and a \$0.4 million increase in facilities expenses. These increases were partially offset by a reduction in consulting fees of \$0.4 million due to the completion of various engineering projects.

Research and development expenses were \$28.1 million in the six months ended December 31, 2014 as compared to \$26.4 million in the six months ended December 31, 2013, which represents an increase of \$1.7 million, or 6%. The increase was primarily due to additional headcount related and IT related expenses which increased \$1.3 million and a \$0.6 million increase in facilities expenses. These increases were partially offset by a reduction in consulting and operational expenses of \$0.3 million due to completion of various engineering projects.

Selling and Marketing

Selling and marketing expenses for the three months ended December 31, 2014 were \$15.8 million as compared to \$14.3 million for the three months ended December 31, 2013, which represents an increase of \$1.5 million, or 11%. Headcount related costs increased by \$1.1 million to support increased sales and commercial activities, and includes increased stock-based compensation expenses of \$0.3 million. Additionally, sales commission expense increased by \$1.0 million due to higher revenue amounts and higher commissions earned in regions with higher commission rates compared to the same period last year. These increases were partially offset by a decrease in consulting related expense of \$0.8 million due to the completion of a marketing study and customer satisfaction survey initiatives in prior year.

Selling and marketing expenses for the six months ended December 31, 2014 were \$33.8 million as compared to \$28.7 million for the six months ended December 31, 2013, which represents an increase of \$5.1 million, or 18%. Headcount in selling and marketing increased by 7% when compared to the same period last year due to an increase in sales and commercial activities which resulted in an increase of \$2.8 million, which includes increased stock-based compensation expenses of \$0.5 million. Sales commission expense increased by \$2.1 million due to higher revenue amounts and higher commissions earned in regions with higher commission rates compared to the same period last year. Travel related expense increased by \$0.3 million due to the increase in headcount. Marketing expense increased by \$1.1 million primarily due to our participation in the ASTRO tradeshow and regional sales meetings held in the first fiscal quarter of 2015. These increases were partially offset by a decrease in consulting related expense of \$1.1 million due to the completion of various marketing initiatives in prior year.

General and Administrative

General and administrative expenses for the three months ended December 31, 2014 were \$12.4 million as compared to \$11.2 million for the three months ended December 31, 2013, which represents an increase of \$1.2 million, or 10%. The increase was primarily related to higher legal departmental expenses of \$1.9 million due to ongoing defense and response to legal matters. The increase was partially offset by decreases in headcount and recruiting related costs of \$0.2 million and lower travel expenses of \$0.1 million.

Edgar Filing: ACCURAY INC - Form 10-Q

General and administrative expenses for the six months ended December 31, 2014 were \$23.3 million as compared to \$22.6 million for the six months ended December 31, 2013, which represents an increase of \$0.7 million, or 3%. The increase was primarily related to higher legal departmental expenses of \$2.3 million. The increase was partially offset by a decrease in consulting expenses of \$0.7 million, decreases of \$0.5 million related to VAT and Sales tax and lower restructuring costs of \$0.4 million.

Other Expense, Net

Other expense, net for the three months ended December 31, 2014 was \$5.5 million as compared to \$3.8 million for the three months ended December 31, 2013, which represents an increase of \$1.7 million. This increase was primarily due to increased foreign currency translation expenses of \$1.2 million primarily due to a stronger U.S. Dollar in comparison to the EURO and the Swiss Franc. Additionally, non cash interest expense increased by \$0.6 million due to the refinancing of our 3.50% Convertible Notes into 3.50% Series A Convertible Notes in the fourth quarter of fiscal 2014.

Other expense, net for the six months ended December 31, 2014 was \$11.0 million as compared to \$6.2 million for the six months ended December 31, 2013, which represents an increase of \$4.8 million. These increases were primarily due to increased foreign currency translation expenses of \$3.5 million primarily due to a stronger U.S. Dollar in comparison to the EURO and the Swiss Franc. Additionally, non cash interest expense increased by \$1.3 million due to the refinancing of our 3.50% Convertible Notes into 3.50% Series A Convertible Notes in the fourth quarter of fiscal 2014.

Table of Contents**Provision for Incomes Taxes**

On a quarterly basis, the Company provides for income taxes based upon an estimated annual effective income tax rate. Income tax expenses were \$0.9 million and \$1.8 million for the three and six months ended December 31, 2014, respectively, compared to income tax expenses of \$1.0 million and \$1.7 million for the three and six months ended December 31, 2013.

Liquidity and Capital Resources

At December 31, 2014, we had \$97.3 million in cash and cash equivalents and \$53.5 million in short-term investments, for a total of \$150.8 million. Also refer to Note 7, Debt to the condensed consolidated financial statements for discussion of the Convertible Notes. Based on our current business plan and revenue prospects, we believe that we will have sufficient cash resources and anticipated cash flows to fund our operations for at least the next 12 months.

In addition, the undistributed earnings of our foreign subsidiaries at December 31, 2014 are considered to be indefinitely reinvested outside the U.S. and unavailable for distribution in the form of dividends or otherwise. Accordingly, no provisions for U.S. income taxes have been provided thereon. We anticipate that we have adequate liquidity and capital resources and would not need to repatriate earnings. As of December 31, 2014, we had approximately \$52.5 million of cash and cash equivalents at our foreign subsidiaries.

Our cash flows for the six months ended December 31, 2014 and 2013 are summarized as follows (in thousands):

	Six months ended December 31,	
	2014	2013
Net cash used in operating activities	\$ (12,985)	\$ (12,910)
Net cash provided by investing activities	21,239	4,413
Net cash provided by financing activities	2,640	3,864
Effect of exchange rate changes on cash and cash equivalents	(5,967)	1,767
Net increase (decrease) in cash and cash equivalents	\$ 4,927	\$ (2,866)

Cash Flows From Operating Activities

Net cash used in operating activities in the six months ended December 31, 2014 was \$13.0 million, as compared to \$12.9 million used in the six months ended December 31, 2013. Net cash used in operating activities in the six months ended December 31, 2014 was primarily related to:

- Net loss of \$31.6 million;

Edgar Filing: ACCURAY INC - Form 10-Q

- Net loss was offset by non-cash items of \$22.5 million related to depreciation of fixed assets, amortization of intangible assets, share-based compensation, amortization and accretion of discount and premium on investments, amortization of debt issuance costs, accretion of interest on long-term debt, recovery of doubtful accounts receivable and provision for excess and obsolete inventory;
- Decrease in accounts receivable of \$6.6 million as a result of collections on customer accounts in excess of billings;
- Increase in inventories of \$18.6 million due to increase in purchases to support expected future sales;
- Decrease in prepaid expenses and other assets of \$2.8 million primarily due to the reduction of prepaid taxes of \$1.8 million primarily in foreign locations due to settlements, a reduction in debt related costs of \$0.8 million due to continued amortization, and a decrease in prepaid commissions of \$0.5 million due to the conversion of deferred revenue into revenue in the second fiscal quarter of 2015. The decrease was offset by an increase in the prepaid insurance balance of \$0.5 million due to the timing of payments;
- Increase in deferred revenue of \$4.4 million primarily due the timing of service contract signing which resulted in more service contract deferrals as compared to prior period with a slight offset related to deferred system revenue which decreased due to additional installations of previously deferred systems;
- Decrease in deferred cost of revenue of \$1.9 million due to additional installations of previously deferred systems;
- Increase in accounts payable of \$1.3 million due to the timing of payments; and
- Decrease in accrued liabilities of \$3.1 million primarily related to the bonus accrual reduction of \$9.1 million due to bonus payments made in the first fiscal quarter of 2015 offset by additional accrual for bonuses for the six months ended December 31, 2014. This decrease

Table of Contents

was partially offset by an increase of \$3.7 million in deferred rent due to a renegotiated lease agreement, an increase of \$1.0 million in legal fees due to the timing of billings and payments for continued matters, and increases of \$0.6 million in interest payable and \$0.3 million in foreign taxes payable due to timing of payments.

Net cash used in operating activities in the six months ended December 31, 2013 was primarily related to:

- Net loss of \$21.0 million;

- Net loss was offset by non-cash items of \$20.7 million related to depreciation of fixed assets, amortization of intangible assets, share-based compensation, amortization and accretion of discount and premium on investments, amortization of debt issuance costs, accretion of interest on long-term debt, recovery of doubtful accounts receivable and provision for excess and obsolete inventory;

- Increase in accounts receivable of \$16.9 million as a result of increased sales;

- Increase in inventories of \$7.7 million due to increases in purchases to support sales;

- Increase in deferred cost of revenue of \$3.5 million and increase in deferred revenue of \$7.5 million primarily due to shipments that were not accepted as of December 31, 2013;

- Decrease in accounts of payable of \$0.9 million due to timing of payments;

- Increase in accrued liabilities of \$6.5 million primarily due to the increase in bonus payable of \$6.8 million; and

- Increase in customer advances of \$3.2 million.

Cash Flows From Investing Activities

Edgar Filing: ACCURAY INC - Form 10-Q

Net cash provided by investing activities was \$21.2 million for the six months ended December 31, 2014, which primarily consisted of sales and maturities of short-term investments of \$81.4 million partially offset by purchases of property and equipment of \$4.2 million and purchases of investments of \$56.0 million.

Net cash provided by investing activities was \$4.4 million for the six months ended December 31, 2013, which primarily consisted of sales and maturities of short-term investments of \$22.8 million, partially offset by purchases of property and equipment of \$6.9 million and purchases of investments of \$11.5 million.

Cash Flows From Financing Activities

Net cash provided by financing activities during the six months ended December 31, 2014 and 2013 was \$2.6 and \$3.9 million, respectively, from proceeds from employee stock plans.

Operating Capital and Capital Expenditure Requirements

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

- Revenue generated by sales of our products and service plans;
- Costs associated with our sales and marketing initiatives and manufacturing activities;
- Facilities, equipment and IT systems required to support current and future operations;
- Rate of progress and cost of our research and development activities;
- Costs of obtaining and maintaining FDA and other regulatory clearances of our products;
- Effects of competing technological and market developments; and
- Number and timing of acquisitions and other strategic transactions.

We believe that our current cash, cash equivalents and investments will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least 12 months. If our cash and cash equivalents are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or debt securities or obtain additional credit facilities. The sale of additional equity or convertible debt securities could result in dilution to our stockholders. If additional funds are raised through the issuance of debt securities, these securities could have rights senior to those associated with our common stock and could contain covenants that would restrict our operations. Additional financing may not be available in amounts or on terms acceptable to us or at all. If we are unable to obtain this additional financing, we may be required to reduce the scope of our planned product development and marketing efforts.

Table of Contents

Contractual Obligations and Commitments

We presented our contractual obligations in our Annual Report on Form 10-K for the fiscal year ended June 30, 2014. There have been no material changes outside of the ordinary course of business in those obligations during the current quarter.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based on our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of these condensed consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, as well as revenue and expenses during the reporting periods. We evaluate our estimates and judgments on an ongoing basis. We base our estimates on historical experience and on various other factors we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities. Actual results could therefore differ materially from those estimates if actual conditions differ from our assumptions.

During the six months ended December 31, 2014 we considered our estimated corporate bonus accrual to be a critical accounting estimate. The Company's bonus accrual for each quarter is based on its performance against Company defined metrics: net revenue, adjusted EBITDA and gross orders to backlog. There have been no other changes to the critical accounting policies and estimates, as discussed in Part II, Item 7 of our Form 10-K for the year ended June 30, 2014, which we believe are those related to revenue recognition, assessment of recoverability of goodwill and intangible assets, valuation of inventories, share-based compensation expense, income taxes, allowance for doubtful accounts and loss contingencies.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency Exchange Rate Risk

A portion of our net sales are denominated in foreign currencies, most notably the Euro and the Japanese Yen. Future fluctuations in the value of the U.S. dollar may affect the price competitiveness of our products outside the United States. For direct sales outside the United States, we sell in both U.S. dollars and local currencies, which could expose us to additional foreign currency risks, including changes in currency exchange

Edgar Filing: ACCURAY INC - Form 10-Q

rates. Our operating expenses in countries outside the United States are payable in foreign currencies and therefore expose us to currency risk, such as risks related to fluctuations in foreign currencies. To the extent that management can predict the timing of payments under sales contracts or for operating expenses that are denominated in foreign currencies, we engage in hedging transactions to mitigate such risks in the future. We expect the changes in the fair value of the intercompany receivables arising from fluctuations in foreign currency exchange rates to be materially offset by the changes in the fair value of the forward contracts. As of December 31, 2014, we had no open forward contracts and all open positions had been settled.

The purpose of these forward contracts is to minimize the risk associated with foreign exchange rate fluctuations. We have developed a foreign exchange policy to govern our forward contracts. These foreign currency forward contracts do not qualify as cash flow hedges and all changes in fair value are reported in earnings as part of other income and expenses. We have not entered into any other types of derivative financial instruments for trading or speculative purpose. Our foreign currency forward contract valuation inputs are based on quoted prices and quoted pricing intervals from public data and do not involve management judgment.

Interest Rate Risk

We maintain an investment portfolio of various holdings, types, and maturities. These securities are generally classified as available for sale and consequently, are recorded on the balance sheet at fair value with unrealized gains and losses reported as a separate component of accumulated other comprehensive income. At any time, a sharp rise or decline in interest rates could have a material adverse impact on the fair value of our investment portfolio. Likewise, increases and decreases in interest rates could have a material impact on interest earnings for our portfolio. The following table presents the hypothetical change in fair values in the financial instruments we held at December 31, 2014 that are sensitive to changes in interest rates. The modeling technique used measures the change in fair values arising from selected potential changes in interest rates on our investment portfolio, which had a fair value of \$53.5 million at December 31, 2014. Market changes reflect immediate hypothetical parallel shifts in the yield curve of plus or minus 100, 75, 50 and 25 basis points (in thousands).

Change in interest rate	Decrease in interest rates				Increase in interest rates			
	-100 BPS	-75 BPS	-50 BPS	-25 BPS	25 BPS	50 BPS	75 BPS	100 BPS
Unrealized gain (loss)	\$ 318	\$ 271	\$ 192	\$ 100	\$ (103)	\$ (205)	\$ (308)	\$ (411)

Table of Contents

Equity Price Risk

On August 1, 2011, we issued \$100 million aggregate principal amount of 3.75% Convertible Notes. Upon conversion, we can settle the obligation by issuing our common stock, cash or a combination thereof at an initial conversion rate equal to 105.5548 shares of common stock per \$1,000 principal amount of the 3.75% Convertible Notes, which is equivalent to a conversion price of approximately \$9.47 per share of common stock, subject to adjustment. There is no equity price risk if the share price of our common stock is below \$9.47 upon conversion of the 3.75% Convertible Notes. For every \$1 that the share price of our common stock exceeds \$9.47, we expect to issue an additional \$10.6 million in cash or shares of our common stock, or a combination thereof, if all of the 3.75% Convertible Notes are converted.

On April 24, 2014, we issued approximately \$70.3 million aggregate principal amount of 3.50% Series A Convertible Notes. Upon conversion, we can settle the obligation by issuing our common stock, cash or a combination thereof at an initial conversion rate equal to 187.6877 shares of common stock per \$1,000 principal amount of the 3.50% Series A Convertible Notes, which is equivalent to a conversion price of approximately \$5.33 per share of common stock, subject to adjustment. There is no equity price risk if the share price of our common stock is below \$5.33 upon conversion of the 3.50% Series A Convertible Notes. For every \$1 that the share price of our common stock exceeds \$5.33, we expect to issue an additional \$13.2 million in cash or shares of our common stock, or a combination thereof, if all of the 3.50% Series A Convertible Notes are converted.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2014. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of December 31, 2014 our disclosure controls and procedures were effective to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

Edgar Filing: ACCURAY INC - Form 10-Q

During the three months ended December 31, 2014, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations of Internal Control Over Financial Reporting

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

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

Please refer to Note 5, Commitments and Contingencies, to the condensed consolidated financial statements above for a description of certain legal proceedings currently pending against the Company. From time to time we are involved in legal proceedings arising in the ordinary course of our business.

Item 1A. Risk Factors.

A description of the risk factors associated with our business is included under Risk Factors contained in Part I, Item 1A of our Form 10-K for the year ended June 30, 2014, as updated in Part II, Item 1A of our quarterly report on Form 10-Q for the quarter ended September 30, 2014, and is incorporated herein by reference. The descriptions below include material changes to the risk factors affecting our business that were previously disclosed in such filings. Any risk factor included below supersedes the description of the relevant risk factor in such filings. Other than the items discussed below, there have been no material changes in our risk factors since such filings.

If third-party payors do not provide sufficient coverage and reimbursement to healthcare providers for use of the CyberKnife and TomoTherapy Systems, demand for our products and our revenue could be adversely affected.

Our customers rely significantly on reimbursement for CyberKnife and TomoTherapy procedures. Our ability to commercialize our products successfully will depend in significant part on the extent to which public and private third party payors provide adequate coverage and reimbursement for procedures that are performed with our products. Third-party payors, and in particular managed care organizations, challenge the prices charged for medical products and services and institute cost containment measures to control or significantly influence the purchase of medical products and services. If reimbursement policies or other cost containment measures are instituted in a manner that significantly reduces the coverage or payment for the procedures that are performed with our products, our existing customers may not continue using our products or may decrease their use of our products, and we may have difficulty obtaining new customers. Such actions would likely have a material adverse effect on our operating results.

On October 31, 2014, the Centers for Medicare and Medicaid Services (CMS) issued the final rule for 2015 Medicare payment rates for hospital outpatient services, physicians and services performed in the freestanding center setting. The proposed rules released by CMS in July 2014 contained multiple proposals that could have impacted reimbursement rates if implemented in the final rule. While some of these proposals were ultimately adopted in the final rule, such as changes to previous coding structures for IMRT and 3D conformal delivery and development of a comprehensive ambulatory payment classification for single fraction cranial radiosurgery, several proposals that could impact reimbursement rates were not implemented or were delayed for future rule making, including delays to payment changes for IMRT and 3D radiation therapy services and robotic radiosurgery delivered in the freestanding center setting and delays to payment changes for IMRT services delivered in the hospital setting. None of changes ultimately implemented in the final rule resulted in any material reductions in payment for CyberKnife or TomoTherapy services in 2015 relative to the rates in effect for calendar year 2014, and in some cases resulted in minor increases to existing payment rates, such as payments for single session cranial SRS in the hospital outpatient setting. However, CMS reviews such rates annually and could implement more significant changes in future years, which could discourage existing and potential customers from purchasing or using our

products.

We have a large accumulated deficit, may incur future losses and may be unable to achieve profitability.

As of December 31, 2014, we had an accumulated deficit of \$386.7 million. We may incur net losses in the future, particularly as we improve our selling and marketing activities. Our ability to achieve and sustain long-term profitability is largely dependent on our ability to successfully market and sell the CyberKnife and TomoTherapy Systems, control our costs, and effectively manage our growth. We cannot assure you that we will be able to achieve profitability. In the event we fail to achieve profitability, our stock price could decline.

As a strategy to assist our sales efforts, we may offer extended payment terms, which may potentially result in higher Days Sales Outstanding and greater payment defaults.

We offer longer or extended payment terms for qualified customers in some circumstances. As of December 31, 2014, customer contracts with extended payment terms of more than one year amounted to less than 4% of our accounts receivable balance. While we qualify customers to whom we offer longer or extended payment terms, their financial positions may change adversely over the longer time period given for payment. This may result in an increase in payment defaults, which would affect our future revenue, as we recognize revenue on such transactions on a cash basis.

Table of Contents

Our liquidity could be adversely impacted by adverse conditions in the financial markets.

At December 31, 2014, we had \$97.3 million in cash and cash equivalents and \$53.5 million in investments. The available cash and cash equivalents are held in accounts managed by third party financial institutions and consist of cash in our operating accounts and cash invested in money market funds and certificates of deposit. The investments are managed by third party financial institutions and consist of U.S. agency, non-US government securities, corporate debt securities and commercial paper. To date, we have experienced no realized losses on or lack of access to our invested cash, cash equivalents or investments; however, we can provide no assurances that access to our invested cash and cash equivalents will not be impacted by adverse conditions in the financial markets.

At any point in time, we also have funds in our operating accounts that are with third party financial institutions that exceed the Federal Deposit Insurance Corporation, or FDIC, insurance limits. While we monitor daily the cash balances in our operating accounts and adjust the cash balances as appropriate, these cash balances could be impacted if the underlying financial institutions fail or become subject to other adverse conditions in the financial markets. To date, we have experienced no loss or lack of access to cash in our operating accounts.

Our major stockholders own approximately 42.7% and directors and executive officers own approximately 1.2% of our outstanding common stock as of December 31, 2014, which could limit other stockholders' ability to influence the outcome of key transactions, including changes of control.

As of December 31, 2014, our current holders of 5% or more of our outstanding common stock held in the aggregate approximately 42.7% of our outstanding common stock, while our directors and executive officers held in the aggregate approximately 1.2% of our outstanding common stock. This concentration of ownership may delay, deter or prevent a change of control of our company and will make some transactions more difficult or impossible without the support of these stockholders.

Our operating results, including our quarterly orders, revenues and margins fluctuate from quarter to quarter and may be unpredictable, which may result in a decline in our stock price if such fluctuations result in a failure to meet the expectations of securities analysts or investors.

We have experienced and expect in the future to experience fluctuations in our operating results, including gross orders, revenues and margins, from period to period. Drivers of orders include the introduction and timing of announcement of new products or product enhancements by us and our competitors, as well as changes or anticipated changes in third party reimbursement amounts or policies applicable to treatments using our products. The availability of economic stimulus packages or other government funding, or reductions thereof, may also affect timing of customer purchases. Our products have a high unit price and require significant capital expenditures by our customers. Accordingly, we experience long sales and implementation cycles, which is of greater concern during the current volatile economic environment where we have had customers delaying or cancelling orders. When orders are placed, installation, delivery or shipping, as applicable, is accomplished and the revenues recognized affect our quarterly results. Further, because of the high unit price of the CyberKnife and TomoTherapy Systems and the relatively small number of units sold or installed each quarter, each sale or installation of a CyberKnife or TomoTherapy System can represent a significant percentage of our net orders, backlog or revenue for a particular quarter.

Edgar Filing: ACCURAY INC - Form 10-Q

Once orders are received and booked into backlog, factors that may affect whether these orders become revenue (or are cancelled or deemed aged-out and reflected as a reduction in net orders) and the timing of revenue include:

- delays in the customer obtaining funding or financing,
- delays in construction at the customer site, or
- delays in the customer obtaining receipt of regulatory approvals such as certificates of need.

Our quarterly operating results may also be affected by a number of other factors which are outside of our control, including:

- timing of when we are able to recognize revenue associated with sales of the CyberKnife and TomoTherapy Systems, which varies depending upon the terms of the applicable sales and service contracts;
- the proportion of revenue attributable to our legacy service plans;
- timing and level of expenditures associated with new product development activities;
- regulatory requirements in some states for a certificate of need prior to the installation of a radiation device;
- delays in shipment due, for example, to unanticipated construction delays at customer locations where our products are to be installed, cancellations by customers, natural disasters or labor disturbances;

Table of Contents

- delays in our manufacturing processes or unexpected manufacturing difficulties;
- timing of the announcement, introduction and delivery of new products or product upgrades by us and by our competitors;
- timing and level of expenditures associated with expansion of sales and marketing activities such as trade shows and our overall operations; and
- fluctuations in our gross margins and the factors that contribute to such fluctuations, as described in the Management's Discussion and Analysis of Financial Condition and Results of Operations.

Because many of our operating expenses are based on anticipated sales and a high percentage of these expenses are fixed for the short term, a small variation in the timing of revenue recognition can cause significant variations in operating results from quarter to quarter. Our overall gross margins are impacted by a number of factors described in our risk factor entitled Our ability to achieve profitability depends in part on maintaining or increasing our gross margins on product sales and service, which we may not be able to achieve. If our gross margins fall below the expectation of securities analysts and investors, the trading price of our common stock would almost certainly decline.

We report on a quarterly and annual basis our orders and backlog. Unlike revenues, orders and backlog are not defined by GAAP, and are not within the scope of the audit conducted by our independent registered public accounting firm; therefore, investors should not interpret our orders or backlog in such a manner. Also, for the reasons set forth above, our orders and backlog cannot necessarily be relied upon as accurate predictors of future revenues. Order cancellation or significant delays in installation date will reduce our backlog and future revenues, and we cannot predict if or when orders will mature into revenues. Particularly high levels of cancellations or age-outs in one or more periods will make it difficult to compare our operating results. Our orders, backlog, revenues and net earnings in one or more future periods may fall below the expectations of securities analysts and investors, which could cause the trading price of our common stock to decline.

The long and variable sales and installation cycle for our CyberKnife and TomoTherapy Systems, which comprise a majority of our revenue, may cause our quarterly results to be inconsistent from period to period.

Our primary products are the CyberKnife and TomoTherapy Systems. We expect to generate substantially all of our revenue for the foreseeable future from sales of and service contracts for the CyberKnife and TomoTherapy Systems. The CyberKnife and TomoTherapy Systems have lengthy sales and purchase order cycles because they are major capital equipment items and require the approval of senior management at purchasing institutions. Selling our systems, from first contact with a potential customer to a complete order, generally spans six months to two years and involves personnel with multiple skills. The sales process in the United States typically begins with pre-selling activity followed by sales presentations and other sales related activities. After the customer has expressed an intention to purchase a CyberKnife or TomoTherapy System, we negotiate and enter into a definitive purchase contract with the customer. The negotiation of terms that are not standard for Accuray may require additional time and approvals. Typically, following the execution of the contract, the customer begins the building or renovation of a radiation-shielded facility to house the CyberKnife or TomoTherapy System, which together with the subsequent installation of the CyberKnife or TomoTherapy System, can take up to 24 months to complete. In order to construct this facility, the customer must typically obtain radiation device installation permits, which are granted by state and local government bodies, each of which may have different criteria

Edgar Filing: ACCURAY INC - Form 10-Q

for permit issuance. If a permit was denied for installation at a specific hospital or treatment center, our CyberKnife or TomoTherapy System could not be installed at that location. In addition, some of our customers are cancer centers or facilities that are new, and in these cases it may be necessary for the entire facility to be completed before the CyberKnife or TomoTherapy System can be installed, which can result in additional construction and installation delays. Our sales and installations of CyberKnife and TomoTherapy Systems tend to be heaviest during the third month of each fiscal quarter.

The long sales cycle, delays in the shipment and installation of CyberKnife and TomoTherapy Systems or customer cancellations, could adversely affect our cash flows and revenue, which would harm our results of operations and may result in significant fluctuations in our reporting of quarterly revenues. Because of these fluctuations, it is likely that in some future quarters, our operating results will fall below the expectations of securities analysts or investors. If that happens, the market price of our stock would likely decrease. These fluctuations also mean that you will not be able to rely upon our operating results in any particular period as an indication of future performance.

Increased leverage as a result of our Convertible Notes offerings may harm our financial condition and operating results.

As of December 31, 2014, we had total consolidated long-term liabilities of approximately \$219.5 million, including the liability component of the 3.75% Convertible Notes in the amount of \$91.1 million, the 3.50% Convertible Notes in the amount of \$44.7 million and the 3.50% Series A Convertible Notes of \$63.4 million.

Table of Contents

Our level of indebtedness could have important consequences to stockholders and note holders, because:

- It could affect our ability to satisfy our obligations under the Convertible Notes;

- A substantial portion of our cash flows from operations will have to be dedicated to interest and principal payments and may not be available for operations, working capital, capital expenditures, expansion, acquisitions or general corporate or other purposes;

- It may impair our ability to obtain additional financing in the future;

- It may limit our flexibility in planning for, or reacting to, changes in our business and industry; and

- It may make us more vulnerable to downturns in our business, our industry or the economy in general.

Table of Contents

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit No.	Exhibit Description	Form	Incorporated by Reference		Filing Date	Filed Herewith
			File No.	Exhibit		
10.1	Eighth Amendment to Lease by and between the registrant and DWF III Caribbean, LLC, dated October 31, 2014					X
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended					X
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended					X
32.1*	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. 1350					X

Edgar Filing: ACCURAY INC - Form 10-Q

101.INS	XBRL Instance Document	X
101.SCH	XBRL Taxonomy Extension Schema Document	X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	X

*The certification attached as Exhibit 32.1 that accompanies this Quarterly Report on Form 10-Q is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Accuray Incorporated under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date of this Quarterly Report on Form 10-Q, irrespective of any general incorporation language contained in such filing.

Table of Contents

SIGNATURES

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

ACCURAY INCORPORATED

By: /s/ Joshua H. Levine
Joshua H. Levine
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ Gregory E. Lichtwardt
Gregory E. Lichtwardt
Executive Vice President and Chief Financial
Officer
(Principal Financial Officer)

Date: February 6, 2014