# FORM 10-K405

## VARIAN MEDICAL SYSTEMS INC - VAR

**Filed: December 23, 1999 (period: October 01, 1999)**

Annual report. The Regulation S-K Item 405 box on the cover page is checked

# Table of Contents

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended October 1, 1999

OR

[_] TRANSITION REPORTING PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number : 1-7598

VARIAN MEDICAL SYSTEMS, INC.
(Exact Name of Registrant as Specified in Its Charter)

| Delaware | 94-2359345 |
|---|---|
| (State or other jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification Number) |
| 3100 Hansen Way, Palo Alto, California (Address of principal executive offices) | 94304-1030 (Zip Code) |

Registrant's telephone number, including area code: (650) 493-4000

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Stock, $1 par value | New York Stock Exchange |
| Preferred Stock Purchase Rights | Pacific Exchange |

Securities registered pursuant to Section 12(g) of the Act: None

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

At December 20, 1999, the aggregate market value of the Common Stock held by non-affiliates of the registrant was approximately $856,866,000.

At December 20, 1999, the number of shares of Common Stock outstanding was 30,680,918.

DOCUMENTS INCORPORATED BY REFERENCE

Definitive Proxy Statement for the Company's 2000 Annual Meeting of Stockholders--Part III of this Form 10-K.

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Varian Medical Systems, Inc.

Index to Annual Report on Form 10-K
For the fiscal year ended October 1, 1999

</TABLE>



## FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains certain "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995 which provides a "safe harbor" for these types of statements. These forward-looking statements are subject to risks and uncertainties that could cause the actual results of Varian Medical Systems, Inc. (the "Company" or "VMS") to differ materially from management's current expectations. These risks and uncertainties include, without limitation, product demand and market acceptance risks; the effect of general economic conditions and foreign currency fluctuations; the impact of competitive products and pricing; new product development and commercialization; reliance on sole source suppliers; the Company's ability to attract and retain key employees; the Company's ability to collect amounts owed in a timely manner; the Company's ability to increase operating margins on higher sales; the impact of managed care initiatives in the U.S. on capital expenditures and resulting pricing pressures on medical equipment; fluctuations in the market for capital equipment; successful implementation by the Company and certain third parties of corrective actions to address the impact of the Year 2000; successful consolidation of the Company's x-ray tube manufacturing operations; the Company's ability to operate as a smaller and less diversified business entity following the recent reorganization; the Company's ability to realize anticipated cost savings from the reorganization; the Company's potential responsibility for liabilities arising out of or relating to the reorganization; the Company's potential responsibility for liabilities arising out of or relating to the reorganization which were not expressly assumed by the Company; the possibility that indemnification for certain liabilities arising out of or relating to the reorganization will not be available to the Company due to the indemnifying party's insolvency or legal prohibition; increased debt leverage resulting from the reorganization impacting the Company's ability to obtain future financing for working capital, capital expenditures, product development, acquisitions and general corporate purposes; the effect of increased debt leverage on cash flow, vulnerability to economic downturns and flexibility in responding to changing business and economic conditions; possible exposure to fraudulent conveyance allegations

arising out of the reorganization; possible exposure to additional tax obligations in connection with the reorganization; and other risks detailed under "Management's Discussion and Analysis of Financial Condition and Results of Operations--Certain Factors Affecting the Company's Business" and, from time to time, in the Company's other filings with the Securities and Exchange Commission. The Company assumes and undertakes no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.



PART I

Item 1. Business

General

In August 1998, the Company (then known as Varian Associates, Inc., "Varian") announced its intention to spin off its instruments business and its semiconductor equipment business to its stockholders. The Company subsequently transferred its instruments business to Varian, Inc. ("VI"), then a wholly owned subsidiary, and transferred its semiconductor equipment business to Varian Semiconductor Equipment Associates, Inc. ("VSEA"), then a wholly owned subsidiary. On April 2, 1999, the Company distributed to its stockholders all of the outstanding shares of common stock of VI and VSEA (the "Distribution"). The business retained by the Company consists of its medical systems business, principally the sales and service of oncology systems, and the sales of x-ray tubes and imaging subsystems. The Company has been engaged in aspects of the medical systems business since 1959.

These transactions were accomplished under the terms of an Amended and Restated Distribution Agreement dated as of January 14, 1999 by and among the Company, VI and VSEA (the "Distribution Agreement"). In addition, for purposes of governing certain ongoing relationships between and among the Company, VI and VSEA after the Distribution, the Company, VI and VSEA entered into certain other agreements, including an Employee Benefits Allocation Agreement, an Intellectual Property Agreement, a Tax Sharing Agreement and a Transition Services Agreement (the "Distribution Related Agreements").

Overview

VMS is a world leader in the design and production of equipment for treating cancer with radiation, as well as high-quality, cost-effective x-ray tubes for original equipment manufacturers, replacement x-ray tubes and imaging subsystems.

In serving the market for advanced medical systems (primarily for cancer care), VMS continues to broaden its offerings to address the unrelenting demand for cost containment and enhanced efficacy which are driving this sector. Its oncology systems line encompasses a fully integrated system of products embracing not only linear accelerators but sophisticated ancillary products and services to extend their capabilities and efficiency. These ancillary offerings now account for almost half of all oncology systems sales.

In addition to developing leading-edge medical hardware, VMS also develops clinical software products and devices that enhance productivity and quality. These developments, while particularly valuable in helping U. S. hospitals and clinics cope with the challenges of managed care, are finding use in markets around the world as health care providers search for new ways to reduce costs, improve efficiency and bring improved levels of care to more patients.

In the X-ray Products business, VMS provides a broad selection of diagnostic tubes capable of delivering more scans with excellent resolution and imaging more patients than its competitors. VMS is also developing a solid state system for digital imaging in collaboration with imaging system manufacturers in several related markets.

Cancer-Care Market

Approximately 50% of all cancer patients in the U. S. receive radiation therapy at some point during the course of their disease. An important advantage of radiation therapy is that the radiation acts with some selectivity on cancer cells. The absorption of radiation by a cell affects its genetic structure and inhibits the replication of the cell, leading to its gradual death. Cancerous cells are fast replicating and thereby are disproportionately damaged by the radiation absorbed.



Currently, the most common type of radiotherapy uses x-rays delivered by external beams and is administered using linear accelerators ("LINACS"). LINACS are conventionally used for multiple, or "fractionated," treatments of a tumor in up to 30 radiation sessions, or, as used more recently in the brain, to deliver a single high dose of radiation in a procedure referred to as stereotactic radiosurgery ("SRS"). In addition to external radiation therapy, radioactive seeds, wires or ribbons are sometimes inserted into a tumor ("interstitially") or into a body cavity ("intracavitary"). These

modalities, known as "brachytherapy," do not require the radiation to pass through surrounding healthy tissue.

Products

VMS's products can be broadly classified into three principal categories: oncology systems, x-ray products, and breakthrough technologies.

Oncology Systems

VMS Oncology Systems designs, manufactures, sells and services hardware and software products for radiation treatment of cancer, including linear accelerators, simulators and computer systems for planning cancer treatments and data management systems for radiation oncology centers. VMS Oncology Systems offers an integrated system of products embracing both linear accelerators and sophisticated ancillary products and services to extend their capabilities and efficiency. VMS's CLINAC(TM) series of medical linear accelerators, marketed to hospitals and clinics worldwide, generate therapeutic x-rays and radiation beams for cancer treatment.

Linear accelerators are also used for industrial radiographic applications. VMS's Linatron linear accelerators are used for nondestructive examination of objects, such as cargo or luggage and to x-ray heavy metallic structures for quality control.

VMS also manufactures and markets related radiotherapy products such as imaging systems, information management systems, multi-leaf collimators, simulators and radiosurgery products. VMS has received U.S. Food and Drug Administration ("FDA") approval of new oncology products including a three-dimensional cancer treatment planning system, and an advanced multileaf collimator used to more precisely direct electron beams for cancer treatment. VMS continually works with physicians and technicians to develop the latest technology and treatments.

X-Ray Products

VMS is a world leader in the design and manufacture of subsystems for diagnostic radiology, including x-ray-generating tubes and imaging subsystems, for the estimated worldwide $7 billion diagnostic imaging market. Its tubes are a key component of x-ray imaging subsystems, including both new system configurations and replacement tubes for the installed base. VMS conducts an active research and development program to address new technology and applications in both the medical and industrial x-ray tube markets. VMS's extensive scientific and engineering expertise in glass and metal center section tubes is considered to be state-of-the-art.

VMS manufactures tubes for four primary medical x-ray imaging applications: CT scanner; radiographic/fluoroscopic; special procedures; and mammography. VMS x-ray tube products have over time substantially increased the heat storage capacity of CT tubes. These high heat unit tubes were developed in response to customers who needed rapid, continuous scanning to accommodate continuous CT scanning techniques over large regions of the patient, and to reduce examination times. Innovative design and process improvements have increased tube life such that VMS's current tubes last twice as long as tubes did five years ago, resulting in significant savings for customers.

VMS mammography tubes produce high quality images at low doses. Today, almost half the mammography systems and nearly a quarter of the CT scanner systems worldwide employ VMS tubes. VMS also offers a



complete line of industrial x-ray tubes. The industrial product line consists of analytical x-ray tubes used for x-ray fluorescence and diffraction as well as tubes used for non-destructive imaging and gauging.

VMS also designs, manufactures and markets imaging products. The imaging product line was launched in September 1996. Amorphous silicon imaging technologies developed by VMS can be broadly applied as an alternative to image intensifiers or film. The new products are expected to increase the efficiency of diagnostic x-ray imaging while decreasing costs. An amorphous silicon imaging subsystem is compact and weighs only about 10 pounds, replacing a 100-lb. image intensifier used in fluoroscopic imaging and the TV camera connected to it. It is expected that imaging equipment based on amorphous silicon semiconductors may be more stable and reliable, have far fewer adjustments, and suffer less degradation over time.

Ginzton Technology Center

In addition to pursuing growth opportunities in existing markets, VMS, through its premier research facility, the Ginzton Technology Center ("GTC") is pursuing the potential in combining advances in focused energy with the latest breakthroughs in biotechnology. The GTC manufactures and sells the Company's brachytherapy products. VariSource(TM) , VMS's high dose rate brachytherapy system, treats tumors internally by delivering radiation to the tumor by means of a radioactive source on the end of a wire in a catheter. It is a cost-effective and efficacious adjunct to linear accelerator-based therapy.

Subsequent to the end of fiscal year 1999, VMS entered into a contract with Cordis Corporation, a subsidiary of Johnson and Johnson Company, for the development, supply and servicing of products and radioactive sources for coronary intravascular radiotherapy treatment to prevent restenosis following angioplasty. The product has not yet received U.S. FDA approval.

VMS is also evaluating the application of radiation to treat other diseases. Such efforts are designed to yield a whole new range of products and technologies that allow VMS to take full advantage of its reputation for technology innovation leadership in the health care field.

Marketing and Sales

Historically, VMS has sold a significant proportion of its products in any particular period to a limited number of customers. Sales to VMS's ten largest customers in fiscal years 1999, 1998 and 1997 accounted for approximately 24%, 24% and 28% of sales, respectively. VMS expects that sales of its products to relatively few customers will continue to account for a high percentage of its sales in the foreseeable future. No single customer accounted for 10% or more of VMS's sales in fiscal year 1999.

VMS sells its products throughout the world through direct sales forces in North America, Australia and major parts of Asia, Europe and Latin America. VMS has 20 sales offices in the United States and 20 sales offices in other countries. Sales in other areas are generally handled by distributors. Sales to customers located in Japan were $75 million in fiscal 1999, $68 million in fiscal 1998, and $67 million in fiscal 1997.

VMS sells its oncology system products primarily to hospitals, clinics, private and governmental institutions and health care agencies and doctors' offices. Total sales for oncology systems and services were $459 million, $405 million and $337 million for fiscal years 1999, 1998 and 1997, respectively. VMS divides its markets for oncology systems, components and accessories by region into North America, Europe, Asia and rest of the world, and these regions constituted 50%, 33%, 12% and 5% of VMS's sales during fiscal year 1999 and 50%, 36%, 8% and 6% during fiscal year 1998, respectively.

VMS sells approximately 80% of its x-ray tube products to original equipment manufacturers ("OEM's") and 20% to replacement tube distributors. VMS has supplied tubes to such industry leaders as Toshiba, Marconi, and Shimadzu, each of which accounted for 5% or more of x-ray tube product sales in fiscal year 1999.



Total sales for X-ray Products were $123 million, $131 million and $130 million for fiscal years 1999, 1998 and 1997, respectively. VMS divides its markets for its x-ray tube products, components and accessories by region into Asia, North America, Europe and rest of the world, and these regions constituted 31%, 23%, 44% and 3% of VMS's sales during fiscal year 1999 and 29%, 25%, 43% and 3% during fiscal year 1998, respectively.

VMS believes that in the foreseeable future there will be world-wide growth in the markets for oncology systems and related services because of the underserved market outside the U.S. With the transition from analog to digital systems, the demand for products and services related to networking, archiving and electronic distribution of digital images will grow in industrialized countries. VMS also believes there will be continuous growth in the markets for information technology.

VMS's marketing strategy is to offer to its customers a complete package of products and services in the fields of radiotherapy, including equipment, accessories and related services such as consulting and after-sales services. VMS's marketing efforts include the development of relationships with current and prospective customers, participation in annual professional meetings for clinicians and hospitals, advertisement in trade journals, direct mail and telephone marketing. VMS's growth strategy is to add products in its existing markets, expand in new high-potential markets, add product offerings through acquisitions and internal development and grow its international market.

Customer Support and Services

VMS maintains service support centers in Milpitas, California; Buc, France; and Tokyo, Japan; as well as field service forces throughout the world for its oncology systems. VMS's network of service engineers and customer support specialists provide installation, warranty, repair, training and support services. VMS generates service revenue by providing service to customers on a time and materials basis and through comprehensive service contracts and the sale of parts.

VMS warrants most of its oncology systems for hardware parts and labor for 12 months. Under the terms of the warranty, the customer is assured of service and parts so that the equipment will operate in accordance with specifications. VMS warrants that software will perform in accordance with specifications at the delivery date and up to three months thereafter if the customer gives notice of any nonconformance. VMS offers a variety of post-warranty service agreements that permit customers to contract for the level of

equipment maintenance they require. In addition, VMS has begun to offer specific software support agreements, reflecting the growing use in VMS's products of software that can be updated. Service is provided at rates competitive with those offered by VMS's competitors.

Systems under warranty or service contract receive periodic maintenance by VMS service engineers, who also install new system capabilities or software upgrades and respond to customer service requests. These services may be purchased from VMS's service organization by customers who do not have a service contract with VMS.

Oncology Systems' customers receive installation, technical training, clinical in-service and documentation support appropriate for the product type. Customers receive both emergency and routine maintenance from a worldwide network of field engineers. These individuals are available to handle service requests 24-hours a day to satisfy VMS's customer requirements. Most of these engineers are employees of VMS, but a few are employees of dealers and/or agents of VMS. Customers can access VMS's extensive service network by calling any of VMS's service centers located throughout North America, Europe, Asia, Australia and Latin America.

VMS believes that its customer service and support are an integral part of its competitive strategy. Service capability, availability and responsiveness play an important role in marketing and selling medical equipment



and systems, particularly as the technological complexity of the products increases. Nevertheless, many hospitals use their own biomedical engineering departments and/or independent service organizations to service equipment after the warranty period expires. Therefore, VMS cannot depend on conversion of all maintenance to service contracts after the warranty period. However, after-warranty service does provide an on-going source of revenue for VMS.

VMS provides technical advice and consultation for x-ray tube products to major OEM customers from offices in Tokyo, Japan; Houten, The Netherlands; and Salt Lake City, Utah and Charleston, South Carolina. VMS applications specialists and engineers make recommendations to meet the customer's technical requirements within the customer's budgetary constraints. VMS often develops specifications for a unique product, which will be designed and manufactured to meet a specific customer's requirements. VMS also maintains a technical customer support group in Charleston, South Carolina to meet the technical support requirements of independent tube installers using VMS's x-ray tube products.

Research and Development

Developing products, systems and services based on advanced technological concepts is essential to VMS's ability to compete effectively. VMS maintains a product research and development and engineering staff responsible for product design and engineering. Research and development expenditures totaled $40 million, $39 million and $31 million in fiscal years 1999, 1998 and 1997, respectively.

VMS's GTC maintains technical competencies in accelerator physics, image processing, electronic design, and materials science for the purpose of proving feasibility of new product concepts and to improve current products. Present research topics include improved accelerator concepts, imaging-based radiotherapy treatment planning, targeting and verification tools, combined modality therapy, manufacturing process improvements, and improved x-ray tubes.

Although VMS intends to continue to conduct extensive research and development activities, there can be no assurance that it will be able to successfully develop and market new products on a cost-effective and timely basis, or at all; that such products will compete favorably with products or product enhancements developed by others, or that VMS's existing technology will not be superseded by new discoveries or developments.

Competition

The health care equipment markets are characterized by rapidly evolving technology, intense competition and pricing pressure. VMS competes with companies worldwide, some of which have greater financial, marketing and management resources than VMS. These competitors could develop technologies and products that are more effective than those currently used or produced by VMS or that could render VMS's products obsolete or noncompetitive. Smaller competitors of VMS could be acquired by companies with greater financial strength enabling them to compete more aggressively. Certain distributors of VMS could also be acquired by competitors thereby disrupting certain distribution arrangements of VMS. Management believes, however, that VMS competes favorably with its competitors on the basis of its continued commitment to global distribution and customer service, value-added manufacturing, technological leadership and new product innovation. VMS believes that the key to success in its markets is to provide technologically superior products that deliver cost-effective, high quality clinical outcomes and that meet or exceed customer quality and service expectations. VMS's ability to compete successfully depends on its ability to commercialize new

products ahead of its competitors. In its sales of oncology systems, VMS competes with Siemens, Nucletron, Elekta and Mitsubishi. In addition, VMS competes with independent service organizations in its service and maintenance business and with a variety of companies in its software systems and accessories business.

The market place for x-ray tube products is extremely competitive. All of the major diagnostic imaging systems companies, which are the primary customers of VMS's x-ray tube business also manufacture x-ray tubes for use in their own products. VMS must compete with these in-house x-ray tube manufacturing operations that



are naturally favored by their parent company. As a result, VMS must have a competitive advantage in one or more significant areas which may include lower product cost, better product quality, or technological superiority. VMS sells a significant volume of its x-ray tube products to companies such as Toshiba Medical Systems, Hitachi Medical Systems, Shimadzu Medical Systems, Philips Medical Systems and General Electric Medical Systems, all of which have in-house x-ray tube production capability. In addition, VMS competes against other stand-alone x-ray tube manufacturers such as Comet, located in Switzerland and IAE, located in Italy. These companies compete with VMS for both the OEM business of major diagnostic imaging equipment manufacturers as well as independent servicers of x-ray tube equipment.

Manufacturing and Supplies

Oncology systems manufactures its linear accelerators in Palo Alto, California, and its treatment simulator systems and accelerator subsystems in Crawley, England. In addition, oncology systems manufactures certain of its ancillary products in Baden, Switzerland and Helsinki, Finland. X-ray tube products are manufactured at VMS's manufacturing facilities in Salt Lake City, Utah and Charleston, South Carolina. GTC manufactures its brachytherapy systems in Crawley, England and other of its products in Charlottesville, Virginia. These facilities employ state-of-the-art manufacturing techniques, and several have been honored by the press, governments, and trade organizations for their commitment to quality improvement. They are registered to ISO 9001 (or ISO 9002, in the case of the Charleston facility), the most rigorous of the international quality standards.

Production processes at VMS facilities include machining, fabrication, subassembly, system assembly and final testing. VMS has invested in various automated and semi-automated equipment for the fabrication and machining of parts and assemblies incorporated in its products. VMS may from time to time further invest in such equipment when cost justified. VMS's quality assurance program includes various quality control measures from inspection of raw material, purchased parts and assemblies through on-line inspection.

VMS's manufacturing activities consist primarily of assembling and testing components and subassemblies, which are acquired from third-party suppliers and then integrated into a finished system by VMS. VMS utilizes an outsourcing strategy for the manufacture of major subassemblies and performs system design, assembly and testing in-house. VMS believes outsourcing enables it to minimize its fixed costs and capital expenditures while also providing it with the flexibility to increase production capacity. VMS purchases material and components from various suppliers that are either standard products or built to VMS specifications. Certain components used in existing products of VMS, as well as products under development, are frequently purchased from single sources.

Backlog

Backlog for VMS amounted to $400 million at the end of fiscal 1999, of which $286 million is expected to be filled within fiscal year 2000. Backlog at the end of fiscal 1998 amounted to $352 million of which $206 million was filled in fiscal year 1999. Backlog for fiscal 1997 amounted to $344 million of which $179 million was filled in fiscal year 1998. VMS includes in backlog only orders for products scheduled to be shipped within two years. Orders may be revised or canceled, either pursuant to their terms or as a result of negotiations; consequently, it is impossible to predict with certainty the amount of backlog orders that will result in sales.

Product Liability

VMS's business exposes it to potential product liability claims which are inherent in the manufacture and sale of medical devices and, as such, VMS may face substantial liability to patients for damages resulting from the faulty design or manufacture of products. Because these products involve the delivery of radiation to the human body or are involved in diagnostic imaging of the human body, the possibility for significant injury and/or death exists with any of VMS's products. Therefore, the design, manufacture, sale or service of the medical products manufactured by VMS involve the risk of product liability claims and expose VMS to substantial liability to patients for damages resulting from the faulty design, manufacture or servicing of such products. Although VMS maintains limited product liability insurance coverage in an amount that it deems sufficient for

its business, there can be no assurance that such coverage will ultimately prove to be adequate or that such coverage will continue to remain available on acceptable terms, if at all.

On December 5, 1997, VMS purchased General Electric's Radiotherapy Service Business (the "RS Business"). In connection with that transaction, VMS agreed to assume liability for certain product defects and personal injury matters which might arise with respect to RS Business products, and obtained insurance for these matters. The insurance provides that in each annual period VMS is responsible for the first $5,000,000 of expenses or liabilities related to any such claims. VMS has been notified of three potential claims related to these RS Business products for which VMS may have an indemnity obligation.

Government Regulation

Domestic Regulation

VMS's products are regulated by the FDA. The FDA regulates the design, development, testing, manufacturing, packaging, labeling, distribution and marketing of medical devices under the U.S. Food, Drug and Cosmetic Act (the "FDC Act") and regulations promulgated by the FDA. The State of California (through its Department of Health Services), where VMS maintains one of its manufacturing facilities, as well as other states, also regulates the manufacture of medical devices.

In general, these laws require that manufacturers adhere to certain standards designed to ensure the safety and effectiveness of medical devices. Under the FDC Act, each medical device manufacturer must comply with requirements applicable to manufacturing practices, clinical investigations involving humans, sale and marketing of medical devices, post-market surveillance, repairs, replacements and refunds, recalls and other matters. The FDA is authorized to obtain and inspect devices and their labeling and advertising, and to inspect the facilities in which they are manufactured.

The FDC Act also requires compliance with specific manufacturing and quality assurance standards, including regulations promulgated by the FDA with respect to good manufacturing practices. FDA regulations require that each manufacturer establish a quality assurance program by which the manufacturer monitors the manufacturing process and maintains records that show compliance with FDA regulations and the manufacturer's written specifications and procedures relating to the devices. Compliance is necessary to receive FDA clearance to market new products and is necessary for a manufacturer to be able to continue to market cleared product offerings. Among other things, these regulations require that manufacturers establish performance requirements before production, ensure that device components are compatible, select adequate packing materials, and, if appropriate, do risk analyses.

The FDA makes announced and unannounced inspections of medical device manufacturers and may issue reports of observations where the manufacturer has failed to comply with applicable regulations and/or procedures. Failure to comply with applicable regulatory requirements can, among other things, result in warning letters, civil penalties, injunctions, suspensions or losses of regulatory clearances, product recalls, seizure or administrative detention of products, operating restrictions through consent decrees or otherwise, and criminal prosecution.

There has been a trend in recent years, both in the United States and abroad, toward more stringent regulation and enforcement of requirements applicable to medical device manufacturers. The continuing trend of more stringent regulatory oversight in product clearance and enforcement activities may cause medical device manufacturers to experience longer approval cycles, more uncertainty, greater risk and higher expenses.

The FDA requires that a new medical device or a new indication for use of or other significant change in an existing medical device obtain either 510(k) pre-market notification clearance or an approved Pre-Market Approval Application ("PMAA") before orders can be obtained and the product distributed in the United States. The 510(k) clearance process is applicable when the new product being submitted is substantially equivalent to



an existing commercially available product. The process of obtaining 510(k) clearance may take at least three months from the date of filing of the application and generally requires the submission of supporting data, which can be extensive and extend the process for a considerable period of time. Under the PMAA process, the applicant must generally conduct at least one clinical investigation and submit extensive supporting data and clinical information in the PMAA, which typically takes from one to two years, but sometimes longer for the FDA to review. Generally, VMS has not been required to resort to the PMAA process for approval of its products.

Software deemed to be a medical device, such as VMS's treatment planning software, is reviewed by the FDA in connection with the agency's clearance of the pre-market notification for the related device. Computer health

information system or stand-alone software may also be subject to FDA regulations. A draft policy issued by the FDA in 1989 has been the applicable guidance for the regulation of computer products intended to affect the diagnosis or treatment of patients. The 1989 draft policy exempts certain software from regulation on the basis of "competent human intervention" occurring with the use of the software before any impact on human health would occur. The FDA is considering a revised policy, which is expected to eliminate this exemption and to base the level of regulation on the level of risk imposed by the product. It is not clear what impact such regulatory policies, if adopted, will have on clinical information systems or other medical software offered by VMS.

VMS believes that it is in material compliance with all applicable federal, state and most foreign regulations regarding the manufacture and sale of its products. Such regulations and their enforcement are, however, constantly undergoing change, and VMS cannot predict what effect, if any, such change may have on its business. Approvals may be withdrawn for failure to comply with regulatory standards or due to the occurrence of unforeseen problems. Failure to comply with FDA regulations could result in warning letters, product approval delays or other sanctions being imposed, including restrictions on the marketing or the recall of VMS's products, injunction or civil penalties. Delays in the receipt of or failure to receive necessary regulatory approvals or the loss of existing approvals could have a material adverse effect on VMS. VMS believes that its products substantially comply with all applicable electrical safety and environmental standards, such as those of Underwriters Laboratories and IEC 601.

VMS is also subject to FDA and Federal Trade Commission restrictions on advertising and numerous foreign, federal, state and local laws relating to such matters as safe working conditions and manufacturing practices. Changes in existing requirements, adoption of new requirements or failure to comply with applicable requirements could have a material adverse effect on VMS.

The design, manufacture, sale or service of the medical products manufactured by VMS involve the risk of product liability claims and exposes VMS to substantial liability to patients for damages resulting from the faulty design, manufacture or servicing of such products. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Certain Factors Affecting the Company's Business--Product Recalls, Product Liability and Insurance."

Medicare and Medicaid Reimbursement

The U.S. federal government regulates reimbursement for diagnostic examinations furnished to Medicare beneficiaries, including related physician services and capital equipment acquisition costs. For example, Medicare reimbursement for operating costs for radiation treatment performed on hospital inpatients generally is set under the Medicare prospective payment system ("PPS") diagnosis-related group ("DRG") regulations. Under PPS, Medicare pays hospitals a fixed amount for services provided to an inpatient based on his or her DRG, rather than reimbursing for the actual costs incurred by the hospital. Patients are assigned to a DRG based on their principal and secondary diagnoses, procedures performed during the hospital stay, age, gender and discharge status.



On October 1, 1991, Medicare began to phase in over a ten-year period a prospective payment system for capital costs which incorporates an add-on to the DRG-based payment to cover capital costs and which replaces the reasonable cost-based methodology. The Balanced Budget Act of 1997 ("BBA"), enacted into law on August 5, 1997, further reduces capital payments to hospitals by 2.1% between October 1, 1997 and September 30, 2002.

For certain hospital outpatient services, including radiation treatment, reimbursement currently is based on the lesser of the hospital's costs or charges, or a blended amount, 42% of which is based on the hospital's reasonable costs and 58% of which is based on the fee schedule amount that Medicare reimburses for such services when furnished in a physician's office. Because the Health Care Financing Administration ("HCFA") has not yet proposed regulations to implement the outpatient PPS, it is unclear what impact changes will have on payment for radiation treatment. Until January 2000, capital acquisition costs for services furnished to hospital outpatients will be reimbursed on the basis of 90% of the reasonable costs actually incurred by the hospital.

Until January 1, 1992, Medicare generally reimbursed physicians on the basis of their reasonable charges or, for certain physicians, including radiologists, on the basis of a "charge-based" fee schedule. On January 1, 1992, Medicare began to phase in over a five-year period a new system that reimburses all physicians, based on the lower of their actual charges or a fee schedule amount based on a "resource-based relative value scale." Relative value units representing practice expenses, such as equipment costs, currently account for approximately 42% of a physician's Medicare fee schedule payment for a particular service. Under the BBA, HCFA is required to implement by July 1, 2000, a revised methodology for calculating practice expense relative value units from the current historical basis to a resource basis. HCFA already has

proposed to establish two separate practice expense values for each physician service, one for when a service is furnished in a facility setting and another for when the service is performed in a physician's office. Typically, for a service that could be provided in either setting, the practice expense value would be higher when the service is performed in a physician's office as it would cover a physician's costs such as for equipment, supplies, and overhead. At this time, HCFA has yet to revise guidelines setting new practice expense values. The revisions that HCFA might make in these values could have a positive or negative affect on physician reimbursement for oncology system services provided in a facility and a positive or negative effect on physician reimbursement for oncology system services provided directly in a physician's office.

Reimbursement for services rendered to Medicaid beneficiaries is determined pursuant to each state's Medicaid plan which is established by state law and regulations, subject to requirements of federal law and regulations. The BBA has revised the Medicaid program to allow states even more control over coverage and payment issues. In addition, the HCFA already has granted many states waivers to allow for greater control of the Medicaid program at the state level. The impact on VMS of this greater state control on Medicaid payment for diagnostic services is uncertain.

The sale of medical devices, the referral of patients for diagnostic examinations utilizing such devices, and the submission of claims to third-party payors (including Medicare and Medicaid) seeking reimbursement for such services, are subject to various federal and state laws pertaining to health care "fraud and abuse," including physician self-referral prohibitions, anti-kickback laws, and false claims laws. Subject to certain enumerated exceptions, the federal physician self-referral law, also known as Stark II, prohibits a physician from referring Medicare or Medicaid patients to an entity in which the physician (or a family member) has an ownership interest or compensation relationship if the referral is for a "designated health service," which is defined explicitly to include radiology services. Although final regulations implementing Stark II have not yet been issued by the United States Department of Health and Human Services, proposed regulations were issued in January 1998. Under the proposed regulations, the definition of radiology services subject to the Stark II restriction would expressly exclude screening mammography services (i.e., mammography services furnished to asymptomatic patients), but not diagnostic mammography (i.e., mammography services furnished to symptomatic patients). The Stark II law, as well as physician self-referral restrictions that exist in a number of states and which apply regardless of whether Medicare or Medicaid patients are involved, may result in lower utilization of certain



diagnostic procedures, which may affect the demand for VMS's products. Anti-kickback laws make it illegal to solicit, offer, receive, or pay any remuneration in exchange for, or to induce, the referral of business, including the purchase of medical devices from a particular manufacturer or the referral of patients to a particular supplier of diagnostic services utilizing such devices. False claims laws prohibit anyone from knowingly and willfully presenting, or causing to be presented, claims for payment to third party payers (including Medicare and Medicaid) that are false or fraudulent, for services not provided as claimed, or for medically unnecessary services. Violations of fraud and abuse laws are prosecuted by the Office of the Inspector General and are punishable by criminal and/or civil sanctions including, in some instances, imprisonment and exclusion from participation in federal health care programs such as Medicare and Medicaid.

The executive branch of the federal government and the Congress from time to time consider various Medicare and other health care reform proposals that could significantly affect both private and public reimbursement for health care services. Some of these proposals, if enacted into law, could reduce reimbursement for or the incentive to use, diagnostic devices and procedures and thus could adversely affect the demand for diagnostic devices, including VMS's products.

Foreign Regulation

Sales of medical devices outside the United States are subject to regulatory requirements that vary from country to country. Specifically, certain foreign regulatory bodies have adopted various regulations governing product standards, packaging requirements, labeling requirements, import restrictions, tariff regulations, duties and tax requirements. For example, in July 1998, the European Union implemented a Medical Device Directive, pursuant to which VMS is required to obtain ISO 9001 certification and affix the required CE mark to its products. The CE mark is an international symbol of adherence to certain quality assurance standards and compliance with applicable European medical device directives which, once affixed, enables a product to be sold in member countries of the European Union. Several Asian countries are reviewing the possibility of adopting similar regulatory schemes. In addition, several countries are reviewing proposed regulations that would require manufacturers to dispose of their products at the end of their useful lives. There can be no assurance that VMS will not be required to incur significant costs in obtaining or maintaining its non-U.S. regulatory approvals. Delays in receipt of or failure to receive such approvals, the loss of previously obtained approvals, or failure to comply with existing or future regulatory

requirements could have a material adverse effect on VMS's business, financial condition and results of operation.

Patent and Other Proprietary Rights

As a leader in the manufacture and sale of oncology systems and x-ray tubes, VMS has pursued a policy of seeking patent, copyright, trademark and trade secret protection in the United States and other countries for developments, improvements, and inventions originating within its organization that are incorporated in VMS's products or that fall within its fields of interest. As of October 1, 1999, VMS owned approximately 67 patents in the United States and approximately 111 patents throughout the rest of the world, and had approximately 115 patent applications on file with various patent agencies worldwide. VMS intends to file additional patent applications as appropriate.

VMS relies on a combination of copyright, trade secret and other laws, and contractual restrictions on disclosure, copying and transferring title to protect its proprietary rights. VMS has trademarks, both registered and unregistered, that are maintained and enforced to provide customer recognition for its products in the marketplace. VMS also has agreements with third parties that provide for licensing of patented or proprietary technology. These agreements include royalty-bearing licenses and technology cross-licenses. While VMS places considerable importance on its licensed technology, VMS does not believe that the loss of any license would have a material adverse effect on VMS's business.

VMS's competitors, like companies in many high technology businesses, routinely review the products of others for possible conflict with their own patent rights. Although VMS has from time to time received notices



of claims from others alleging patent infringement, VMS believes that there are no pending patent infringement claims that might have a material adverse effect on the business of VMS.

Environmental Matters

For a discussion of environmental matters, see "Management's Discussion and Analysis of Financial Condition and Results of Operations--Environmental Matters."

Employees

At October 1, 1999, VMS had a total of approximately 2,350 full-time and temporary employees worldwide, 1,710 in the United States and 640 elsewhere. This total includes 50 employees performing transition services for VSEA and VI in order to complete the separation and distribution of the information technology infrastructure.

None of VMS's employees based in the United States are unionized or subject to collective bargaining agreements. Employees based in certain foreign countries may, from time to time, be subject to collective bargaining agreements. VMS currently considers its employee relations to be good.

VMS's success depends to a significant extent upon a limited number of key employees and other members of senior management of VMS. The loss of the service of one or more of these key employees could have a material adverse effect on VMS. The success of VMS's future operations depends in large part on VMS's ability to recruit and retain engineers and technicians, as well as marketing, sales, service and other key personnel, who in each case are in great demand. VMS's inability to attract and retain the personnel it requires could have a material adverse effect on VMS's results of operations.



## EXECUTIVE OFFICERS

Certain information regarding the executive officers of VMS as of December 15, 1999 is set forth below:

| Name | Age | Position |
|---|---|---|
| Richard M. Levy..... President and Chief Executive Officer | 61 | Dr. Levy became President and Chief Executive Officer of VMS on April 3, 1999. Prior to April 2, 1999, he was the Executive Vice President of the Company responsible for the medical systems business. Dr. Levy also oversaw the Company's Edward L. Ginzton Technology Center in Palo Alto. He joined the Company in 1968, and was elevated to Executive Vice President in 1990. |
| Timothy E. Guertin..... Corporate Vice President | 50 | Mr. Guertin became Corporate Vice President of VMS on April 3, 1999. Prior to April 2, 1999, he |

| | | |
|---|---|---|
| | | was Corporate Vice President and President of Varian's Oncology Systems business, positions he held from 1992 and 1990, respectively. Mr. Guertin has held various other positions in the medical systems business during his 24 years with the Company. |
| John C. Ford..... Corporate Vice President | 55 | Dr. Ford became Corporate Vice President of VMS on April 3, 1999. Prior to April 2, 1999, he was Senior Vice President, Business Development, for the Company's medical systems business, a position he held from 1992. Dr. Ford has held various other positions in the medical systems business during his 27 years with the Company. |
| Robert H. Kluge..... Corporate Vice President | 53 | Mr. Kluge became Corporate Vice President of VMS on April 3, 1999. Prior to April 2, 1999, he was Vice President and General Manager of Varian's x-ray tube products business, positions he held from 1993. Before joining the Company in 1993, he held various positions with Picker International (an x-ray systems manufacturer). |
| Elisha W. Finney..... Corporate Vice President, Chief Financial Officer and Treasurer | 38 | Ms. Finney became Corporate Vice President and Chief Financial Officer of VMS on April 3, 1999. She has been Treasurer of the Company since January 1998. From 1988 to 1998, she was the Company's Risk Manager and from 1995 to 1998, Ms. Finney also served as Assistant Treasurer. Ms. Finney held various other positions during her 11 years with the Company. |
| Joseph B. Phair..... Corporate Vice President, Administration, General Counsel and Secretary | 52 | Mr. Phair became Corporate Vice President, Administration of VMS on August 20, 1999. Between April 2, 1999 and August 20, 1999, he was a consultant to the Company. Mr. Phair has been General Counsel of the Company since 1990 and Secretary since 1991. Mr. Phair was a Vice President of the Company from 1990 until April 2, 1999, and has held various other positions in the Company's legal department during his 20 years with the Company. |
| Duane A. Walstrom..... Corporate Controller | 48 | Mr. Walstrom became Corporate Controller of VMS on April 3, 1999. Prior to April 2, 1999, he was Director, Accounting of the Company, a position he held since 1985. Mr. Walstrom held various other accounting and finance positions during his 17 years with the Company. |



Item 2. Properties

VMS's executive offices and oncology management and manufacturing facilities are located in Palo Alto, California on 30 acres of land under a leasehold which expires from 2012 through 2058. These facilities are owned by the Company and contain an aggregate floor space of 248,902 square feet. The Ginzton Technology Center is located in Mountain View, California under a lease that expires in 2004. VMS manufacturing facilities are located in Salt Lake City, Utah; Charleston, South Carolina; Crawley, England; Baden, Switzerland; and Helsinki, Finland. VMS's 40 service and sales facilities also are located throughout the world, with 20 located outside of the United States, including Australia, Brazil, China, Denmark, Finland, France, Germany, Hong Kong, Italy, Japan, The Netherlands, Spain, Switzerland, Thailand and the United Kingdom.

The following is a summary of the Company's properties at October 1, 1999:

| | Land (Acres) | | Buildings (000's Sq. Ft.) | | Number of Buildings | |
|---|---|---|---|---|---|---|
| | Owned | Leased | Owned | Leased | Owned | Leased |
| United States..... | 38 | 30 | 521 | 340 | 7 | 26 |
| International..... | 2 | -- | 46 | 118 | 1 | 26 |
| | 40 | 30 | 567 | 458 | 8 | 52 |

Utilization of facilities by segment is shown in the following table:

| | Buildings (000's Sq. Ft.) | | | | |
|---|---|---|---|---|---|
| | Manufacturing, Administrative and Research & Development | | | | |
| | U.S. | Non-U.S. | Total | Marketing and Service | Total |
| Oncology Systems | 215 | 65 | 280 | 211 | 491 |
| X-ray Products | 386 | 3 | 389 | 9 | 397 |
| Ginzton Technology Center | 26 | 2 | 28 | 4 | 32 |
| Total Operations | 627 | 70 | 697 | 223 | 920 |
| Other Operations | 88 | 17 | 105 | -- | 105 |
| Total | 715 | 87 | 802 | 223 | 1,025 |

Other Operations includes manufacturing support.

The management of VMS does not believe that there is any material long-term excess capacity in its facilities, although utilization is subject to change based on customer demand. The management of VMS believes that its facilities and equipment generally are well maintained, in good operating condition and suitable for VMS's purposes and adequate for present operations.

Item 3. Legal Proceedings

Set forth below is information on the current status of previously reported legal proceedings.

VMS is a party to three related federal actions involving claims by independent service organizations ("ISOs") that its policies and business practices relating to replacement for Oncology Systems' parts violate the antitrust laws (the "ISOs Litigation"). The ISOs purchase replacement parts from VMS and compete with it for the servicing of linear accelerators made by VMS. In response to several threats of litigation regarding the legality of VMS's parts policy, VMS filed a declaratory judgment action in a U. S. District Court in 1996 seeking a determination that its new policies are legal and enforceable and damages against two of the ISOs for misappropriation of VMS's trade secrets, unfair competition, copyright infringement and related claims. Subsequently, four of the defendants filed separate claims in other jurisdictions raising issues allegedly related to those in the declaratory relief action and seeking injunctive relief against VMS and damages against VMS in the



amount of $10 million for each plaintiff. The defendants' motion for a preliminary injunction in U. S. District Court in Texas with respect to the VMS's was defeated. The ISOs defendants amended the complaint to include class action allegations, allege a variety of other anti-competitive business practices and filed a motion for class certification, which was heard by the U. S. District Court in Texas in July 1999. No decision, however, has been entered.

Following the Distribution, VMS retained the liabilities related to the medical systems business prior to the Distribution, including the ISOs Litigation. In addition, under the terms of the Distribution Agreement, the Company agreed to manage and defend liabilities related to legal proceedings and environmental matters arising from corporate or discontinued operations of the Company prior to the Distribution. Under the terms of the Distribution Agreement, VI and VSEA generally are each obligated to indemnify VMS for one-third of these liabilities (after adjusting for any insurance proceeds realized or tax benefits recognized by VMS), including certain environmental-related liabilities described below, and to fully indemnify VMS for liabilities arising from the operations of the business transferred to each prior to the Distribution. The availability of such indemnities will depend upon the future financial strength of VI and VSEA. No assurance can be given that the relevant company will be in a position to fund such indemnities. It is also possible that a court would disregard this contractual allocation of indebtedness, liabilities and obligations among the parties and require VMS to assume responsibility for obligations allocated to another party, particularly if such other party were to refuse or was unable to pay or perform any of its allocated obligations. In addition, the Distribution Agreement generally provides that if a court prohibits a company from satisfying its indemnification obligations, then such indemnification obligations will be shared equally between the two other companies.

VMS is also involved in certain other legal proceedings arising in the ordinary course of its business. While there can be no assurances as to the ultimate outcome of any litigation involving VMS, management does not believe any pending legal proceeding will result in a judgment or settlement that will have a material adverse effect on VMS's financial position or results of operations.

The Company has been named by the U.S. Environmental Protection Agency or third parties as a potentially responsible party under the Comprehensive Environmental Response Compensation and Liability Act of 1980, as amended, at eight sites where Varian is alleged to have shipped manufacturing waste for recycling or disposal. The Company is also involved in various stages of environmental investigation and/or remediation under the direction of, or in consultation with, federal, state and/or local agencies at certain current VMS or former Varian facilities (including facilities disposed of in connection with Varian's sale of its Electron Devices business during 1995 and the sale of its Thin Film Systems business during 1997). Under the terms of the Distribution Agreement, VI and VSEA are each obligated to indemnify VMS for one-third of these environmental-related investigation and remediation costs (after adjusting for any insurance proceeds realized or tax benefits recognized by VMS). Expenditures for environmental investigation and remediation amounted to $0.9 million in fiscal year 1999, $1.7 million in fiscal year 1998 and $0.8 million in fiscal year 1997, net of amounts that would have been borne by VI and VSEA.

For certain of these sites and facilities, various uncertainties make it difficult to assess the likelihood and scope of further investigation or remediation activities or to estimate the future costs of such activities if undertaken. As of October 1, 1999, VMS nonetheless estimated that VMS's future exposure (net of VI and VSEA's indemnification obligations) for environmental-related investigation and remediation costs for these sites ranged in the aggregate from $12.4 million to $29.8 million. The time frame over which VMS expects to incur such costs varies with each site, ranging up to approximately 30 years as of October 1, 1999. Management believes that no amount in the foregoing range of estimated future costs is more probable of being incurred than any other amount in such range and therefore accrued $12.4 million in estimated environmental costs as of October 1, 1999. The amount accrued has not been discounted to present value.

As to other sites and facilities, VMS has gained sufficient knowledge to be able to better estimate the scope and costs of future environmental activities. As of October 1, 1999, VMS estimated that its future exposure



(net of VI and VSEA's indemnification obligations) for environmental-related investigation and remediation costs for these sites and facilities ranged in the aggregate from $22.9 million to $39.0 million. The time frame over which these costs are expected to be incurred varies with each site and facility, ranging up to approximately 30 years as of October 1, 1999. As to each of these sites and facilities, management determined that a particular amount within the range of estimated costs was a better estimate of the future environmental liability than any other amount within the range, and that the amount and timing of these future costs were reliably determinable. Together, these amounts totaled $26.7 million at October 1, 1999. VMS accordingly accrued $11.9 million, which represents its best estimate of the future costs discounted at 4%, net of inflation. This accrual is in addition to the $12.4 million described in the preceding paragraph.

The foregoing amounts are only estimates of anticipated future environmental-related costs, and the amounts actually spent may be greater or less than such estimates. The aggregate range of cost estimates reflects various uncertainties inherent in many environmental investigation and remediation activities and the large number of sites and facilities involved. VMS believes that most of these cost ranges will narrow as investigation and remediation activities progress. VMS believes that its reserves are adequate, but as the scope of its obligations becomes more clearly defined, these reserves (and the associated indemnification obligations of VI and VSEA) may be modified and related charges against earnings may be made.

Although any ultimate liability arising from environmental-related matters described herein could result in significant expenditures that, if aggregated and assumed to occur within a single fiscal year, would be material to VMS's financial statements, the likelihood of such occurrence is considered remote. Based on information currently available to management and its best assessment of the ultimate amount and timing of environmental-related events (and assuming VI and VSEA satisfy their indemnification obligations), management believes that the costs of these environmental-related matters are not reasonably likely to have a material adverse effect on the consolidated financial statements of VMS.

VMS evaluates its liability for environmental-related investigation and remediation in light of the liability and financial wherewithal of potentially responsible parties and insurance companies with respect to which VMS believes that it has rights to contribution, indemnity and/or reimbursement (in addition to the obligations of VI and VSEA). Claims for recovery of environmental investigation and remediation costs already incurred, and to be incurred in the future, have been asserted against various insurance companies and other third parties. In 1992, Varian filed a lawsuit against 36 insurance companies with respect to most of the above-referenced sites and facilities. Varian received certain cash settlements during fiscal years 1995, 1996, 1997 and 1998 from defendants in that lawsuit. The Company has also reached an agreement with another insurance company under which the insurance company has agreed to pay a portion of the Company's past and future environmental-related

expenditures, and VMS therefore has a $3.6 million receivable in Other Assets at October 1, 1999. VMS believes that this receivable is recoverable because it is based on a binding, written settlement agreement with a solvent and financially viable insurance company. Although VMS intends to aggressively pursue additional insurance and other recoveries, VMS has not reduced any liability in anticipation of recovery with respect to claims made against third parties.

Item 4. Submission of Matters to a Vote of Security Holders

Inapplicable.



PART II

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters

The Company's common stock is traded on the New York Stock Exchange and Pacific Exchange under the symbol VAR. The following table sets forth, for the periods indicated, the highest and lowest closing sales prices for Varian's common stock as reported in the consolidated transaction reporting system for the New York Stock Exchange in fiscal year 1998 and for the first half of fiscal year 1999.

| | High | Low |
|---|---|---|
| Fiscal Year 1998 | | |
| First Quarter | $66 3/4 | $47 3/4 |
| Second Quarter | 58 3/8 | 47 1/2 |
| Third Quarter | 53 15/16 | 38 3/16 |
| Fourth Quarter | 43 | 31 13/16 |
| Fiscal Year 1999 | | |
| First Quarter | 41 1/16 | 32 7/16 |
| Second Quarter | 43 | 31 3/4 |

On April 2, 1999, the end of the first half of fiscal year 1999, Varian distributed to its stockholders all of the outstanding shares of common stock of each of VI and VSEA. Following the Distribution, the highest and lowest closing sales prices for VMS's common stock as so reported were:

| | High | Low |
|---|---|---|
| Fiscal Year 1999 | | |
| Third Quarter | $25 1/4 | $16 5/8 |
| Fourth Quarter | 24 3/16 | 19 7/16 |

Varian declared cash dividends of $0.09 in the first quarter of fiscal year 1998, and $0.10 in each quarter thereafter through the first quarter of fiscal year 1999. Since the Distribution, the Company has not paid any dividends on the common stock and does not currently anticipate paying dividends on the common stock for the foreseeable future. Further, the existing financing arrangements of the Company contain provisions that limit the ability of the Company to pay dividends.

As of December 15, 1999, there were approximately 5,184 holders of record of the Company's common stock.



Item 6. Selected Financial Data

The following selected statements of earnings and balance sheet data of the Company as of and for the fiscal years ended September 29, 1995, September 27, 1996, September 26, 1997, October 2, 1998 and October 1, 1999 have been derived from the Company's audited consolidated financial statements. The financial data set forth below should be read in conjunction with the consolidated financial statements of the Company and related notes thereto, the supplemental data and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere herein.

| | Fiscal Years | | | | |
|---|---|---|---|---|---|
| | 1999 | 1998 | 1997 | 1996 | 1995 |
| | (Dollars in millions, except per share amounts) | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Summary of Operations: | | | | | |
| Sales | $ 590.4 | $ 541.5 | $ 474.3 | $ 467.5 | $ 500.1 |
| Earnings from Continuing Operations before Taxes | $ 18.2 | $ 36.0 | $ 29.2 | $ 25.0 | $ 50.3 |
| Taxes on earnings | $ 10.0 | $ 9.9 | $ 9.2 | $ 7.4 | $ 16.4 |
| Earnings from Continuing Operations | $ 8.2 | $ 26.1 | $ 20.0 | $ 17.6 | $ 33.9 |
| Earnings from Discontinued Operations, Net of Taxes | $ (32.4) | $ 47.7 | $ 95.6 | $ 104.5 | $ 105.4 |
| Net Earnings (Loss) | $ (24.2) | $ 73.8 | $ 115.6 | $ 122.1 | $ 139.3 |
| Net Earnings (Loss) Per Share-Basic | | | | | |
| Continuing Operations | $ 0.27 | $ 0.87 | $ 0.66 | $ 0.57 | $ 1.01 |
| Discontinued Operations | $ (1.07) | $ 1.60 | $ 3.13 | $ 3.36 | $ 3.13 |
| Net Earnings (Loss) Per Share-Basic | $ (0.80) | $ 2.47 | $ 3.79 | $ 3.93 | $ 4.14 |
| Net Earnings (Loss) Per Share-Diluted | | | | | |
| Continuing Operations | $ 0.27 | $ 0.86 | $ 0.64 | $ 0.55 | $ 0.97 |
| Discontinued Operations | $ (1.06) | $ 1.57 | $ 3.03 | $ 3.26 | $ 3.00 |
| Net Earnings (Loss) Per Share-Diluted | $ (0.79) | $ 2.43 | $ 3.67 | $ 3.81 | $ 3.97 |
| Dividends Declared Per Share | $ 0.10 | $ 0.39 | $ 0.35 | $ 0.31 | $ 0.27 |
| Financial Position at Year End: | | | | | |
| Working capital | $ 112.4 | $ 334.9 | $ 349.2 | $ 293.9 | $ 257.0 |
| Total assets | $ 539.2 | $ 1,218.3 | $ 1,104.3 | $ 1,018.9 | $ 1,003.8 |
| Short-term borrowings | $ 35.6 | $ 46.8 | $ 18.7 | $ 4.4 | $ 1.8 |
| Long-term borrowings | $ 58.5 | $ 111.1 | $ 73.2 | $ 60.3 | $ 60.3 |
| Stockholders' equity | $ 185.0 | $ 557.5 | $ 524.6 | $ 467.9 | $ 394.9 |

The Summary of Operations data presented above for all periods has been restated to reflect as discontinued operations the activities associated with the Company's former semiconductor equipment business and its instrument business which were transferred to VSEA and VI, respectively, and the shares of those entities distributed to the Company's stockholders on April 2, 1999. The balance sheet data as of October 1, 1999 also reflects the Distribution. Fiscal year 1999 results from continuing operations include net reorganization related charges of $29.7 million ($25.7 million after-tax or $0.84 per diluted share.) This selected financial data should be read in conjunction with the related consolidated financial statements and notes thereto.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

In August 1998, the Company (then known as Varian Associates, Inc., "Varian") announced its intention to spin off its instruments business and its semiconductor equipment business to its stockholders. The Company



subsequently transferred its instruments business to Varian, Inc. ("VI"), a wholly owned subsidiary, and transferred its semiconductor equipment business to Varian Semiconductor Equipment Associates, Inc. ("VSEA"), a wholly owned subsidiary. On April 2, 1999, the Company distributed to holders of shares of the common stock of the Company all of the outstanding shares of common stock of VI and VSEA (the "Distribution").

These transactions were accomplished under the terms of an Amended and Restated Distribution Agreement dated as of January 14, 1999 by and among the Company, VI and VSEA (the "Distribution Agreement"). In addition, for purposes of governing certain ongoing relationships between and among the Company, VI and VSEA after the Distribution, the Company, VI and VSEA entered into certain other agreements, including an Employee Benefits Allocation Agreement, an Intellectual Property Agreement, a Tax Sharing Agreement and a Transition Services Agreement (the "Distribution Related Agreements").

The business retained by the Company consists of its medical systems business, principally the sales and service of oncology systems, and the sales of x-ray tubes and imaging subsystems. Immediately following the Distribution, the Company changed its name to Varian Medical Systems, Inc. ("VMS").

The financial statements included in this report present VI and VSEA as discontinued operations pursuant to Accounting Principles Board Opinion No. 30

"Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." The net operating results of VI and VSEA are reported as "Earnings (Loss) from Discontinued Operations-Net of Taxes." In determining the items attributable to these businesses, the Company, among other things, allocated certain Varian corporate assets (including pension assets), liabilities (including profit-sharing and pension benefits), and expenses (including legal, accounting, employee benefits, insurance, information technology services, treasury and other corporate overhead) to VI and VSEA. While management believes the methods used to allocate the amount of these items to VI and VSEA are reasonable, the balances retained by the Company are not necessarily indicative of the amounts that would have been recorded by the Company had the Distribution occurred prior to the dates of the financial statements affected by these allocations, or that have been recorded by the Company after the Distribution or that will be recorded in the future. The following discussion and analysis pertains to the continuing operations of the Company, unless otherwise noted.

This discussion and analysis of financial condition and results of operations is based upon and should be read in conjunction with the consolidated financial statements and the notes thereto included elsewhere in this report, as well as the information contained under "Certain Factors Affecting the Company's Business" below.

Results of Operations

Fiscal Year

VMS's fiscal year is the 52- or 53-week period ending on the Friday nearest September 30. Fiscal year 1999 comprises the 52-week period ended on October 1, 1999. Fiscal years 1998 and 1997 comprise the 53- and 52-week periods ended on October 2, 1998 and September 26, 1997, respectively.

Fiscal Year 1999 Compared to Fiscal Year 1998

Sales. VMS's sales of $590 million in fiscal year 1999 were 9% higher than its sales of $541 million in fiscal year 1998. International sales were $318 million, or 54% of sales, in fiscal year 1999, compared to $299 million, or 55% of sales, in fiscal year 1998. Sales to customers in Japan were $75 million in fiscal year 1999 compared to $68 million in fiscal year 1998.

Oncology Systems sales increased 13%, amounting to $459 million, or 78% of VMS's sales, in fiscal year 1999, compared to $405 million, or 75% of sales, in fiscal year 1998. Oncology Systems sales in North America, Europe, Asia and the rest of the world amounted to $229 million, $155 million, $54 million and $21 million in fiscal year 1999, and $202 million, $149 million, $31 million and $23 million in fiscal year 1998, respectively. Fourth quarter sales represented 34% of total sales in fiscal year 1999 and 33% in fiscal year 1998.



X-ray Products sales were $123 million, or 21% of VMS's sales, in fiscal year 1999, compared to $131 million, or 24% of sales, in fiscal year 1998. Sales of x-ray tubes and imaging subsystems in North America, Europe, Asia and the rest of the world amounted to $38 million, $28 million, $54 million and $3 million in fiscal year 1999 and $38 million, $33 million, $56 million and $4 million in fiscal year 1998, respectively. The 6% decrease in x-ray tubes and imaging subsystems sales between fiscal year 1999 and fiscal year 1998 reflected continuing decrease in x-ray tube sales volumes due in part to continued consolidation of original equipment manufacturer customers.

GTC sales were $8 million in fiscal year 1999, compared to $5 million in fiscal year 1998. The increase was due to an increase in brachytherapy sales.

Gross Profit. VMS recorded gross profit of $210 million in fiscal year 1999 and $195 million in fiscal year 1998. As a percentage of sales, gross profit was 36% of sales in both fiscal year 1999 and in fiscal year 1998. Gross profit as a percentage of sales of Oncology Systems and X-ray Products which includes imaging subsystems were 37% and 34%, respectively, in both fiscal year 1999 and fiscal year 1998.

Research and Development. VMS's research and development expenses were $40 million in fiscal year 1999 compared to $39 million in fiscal year 1998, amounting to 7% of sales in both years.

Selling, General and Administrative. VMS's selling, general and administrative expenses were $116 million, or 20% of sales, in fiscal year 1999 compared to $118 million, or 22% of sales, in fiscal year 1998. The decrease relates primarily to the inclusion of allocated general overhead costs for all of fiscal year 1998 compared to only the first six months of fiscal year 1999. These expenses consist primarily of corporate costs incurred prior to the Distribution which cannot be allocated to discontinued operations under generally accepted accounting principles. Selling expenses increased proportionally to the increase in sales from fiscal year 1998 to fiscal year 1999.

Reorganization Costs. Fiscal year 1999 expenses included net reorganization

charges of $29.7 million, of which $24.9 million was incurred as a result of the Distribution and $4.8 million was incurred as a result of VMS's restructuring of its X-ray Products segment by the closing of a manufacturing facility in Arlington Heights, Illinois to consolidate manufacturing at VMS's existing facilities in Salt Lake City, Utah. The $29.7 million net charge includes $34.3 million for retention bonuses for employee services provided prior to October 1, 1999, employee severance and executive compensation; $21.0 million for legal, accounting, printing and investment banking fees; $1.7 million for foreign taxes (excluding income taxes) resulting from the international reorganization of the Company's subsidiaries in connection with the Distribution; and $6.8 million in other costs associated with the Distribution and restructuring; partially offset by a $34.1 million gain on the sale of the Company's aircraft and long-term leasehold interests in certain of its Palo Alto facilities, together with the related buildings, and other corporate assets.

The following table sets forth certain details associated with these net reorganization charges (in thousands of dollars):

| | Reorganization Costs as of October 1, 1999 | Cash (Payments) Receipts | Non-Cash Transactions | Accrual at October 1, 1999 |
|---|---|---|---|---|
| Retention bonuses, severance, and executive compensation | $ 34,307 | $(29,800) | $ -- | $4,507 |
| Legal, accounting, printing and investment banking fees | 20,982 | (19,190) | -- | 1,792 |
| Gain on sale of real estate and corporate assets | (34,098) | 50,948 | (16,850) | -- |
| Foreign taxes (excluding income taxes) | 1,700 | (18) | (1,006) | 676 |
| Other | 6,777 | (4,393) | (1,016) | 1,368 |
| | $ 29,668 | $ (2,453) | $(18,872) | $8,343 |



It is anticipated that a majority of the remaining accrual will be paid during fiscal year 2000.

Taxes on Earnings. The Company's effective tax rate was 55% in fiscal year 1999, compared to 27% in fiscal year 1998. The fiscal year 1999 rate is significantly higher than the fiscal year 1998 rate principally due to the non-deductibility of certain reorganization costs related to the Distribution.

Interest expense, net. VMS's net interest expense was $6.1 million in fiscal year 1999 compared to $2.4 million in fiscal year 1998. In connection with the Distribution, the Company contributed $119 million to VSEA and VI, resulting in lower cash balances and lower interest income. In addition, interest expense increased due primarily to higher levels of short-term borrowings.

Net Earnings. The Company's net earnings from continuing operations were $8 million in fiscal year 1999, compared to net earnings of $26 million in fiscal year 1998. The decrease in net earnings is primarily attributable to reorganization-related net expenses associated with the Distribution.

Fiscal Year 1998 Compared to Fiscal Year 1997

Sales. VMS's sales of $541 million in fiscal year 1998 were 14% higher than its sales of $474 million in fiscal year 1997. Fourth fiscal quarter sales were significant in both years, accounting for $179 million of sales in fiscal year 1998 and $158 million of sales in fiscal year 1997, amounting to 33% of sales in each fiscal year.

Oncology Systems sales were $405 million, or 75% of total sales, in fiscal year 1998, compared to $337 million, or 71% of sales, in fiscal year 1997. X-ray Products sales were $131 million, or 24% of VMS's sales, in fiscal year 1998, compared to $130 million, or 27% of sales, in fiscal year 1997. Oncology Systems sales accounted for essentially all of the increase in sales in fiscal year 1998. The 20% increase in sales of Oncology Systems between fiscal year 1997 and fiscal year 1998 reflects both an increase in volume of products and services sold and the acquisition of the radiotherapy services business from the General Electric Company ("the RS Business") in December 1997. GTC sales were $5 million in fiscal year 1998, compared to sales of $7 million in fiscal year 1997 due to the slight decrease in revenues from customer-funded research projects in fiscal year 1998.

By product line, Oncology Systems sales in North America, Europe, Asia and the rest of the world amounted to $202 million, $149 million, $31 million and

$23 million in fiscal year 1998, and $190 million, $89 million, $43 million and $15 million of sales in fiscal year 1997, respectively, while sales of x-ray tubes and imaging subsystems in North America, Europe, Asia and the rest of the world amounted to $38 million, $33 million, $56 million and $4 million in fiscal year 1998, and $34 million, $31 million, $63 million and $2 million in fiscal year 1997, respectively. The economic difficulties in Asia were responsible for the reduction in Asian sales between fiscal year 1997 and 1998, however sales to customers in Japan were relatively flat representing $68 million in fiscal year 1998 compared to $67 million in fiscal year 1997.

Gross Profit. VMS's gross profit of $195 million in fiscal year 1998 was 36% of sales, compared to $164 million, or 34.5% of sales, in fiscal year 1997. The increase in gross profit as a percentage of sales from fiscal year 1997 to fiscal year 1998 was primarily attributable to the increase in Oncology Systems sales relative to the fixed components of overhead and, to a lesser extent, a shift in oncology systems sales to a higher mix of ancillary products that bear a higher margin. In addition, gross profit was positively influenced by a favorable LIFO adjustment in 1998. Gross profit as a percentage of sales of Oncology Systems amounted to 37% in fiscal year 1998, compared to 35% in fiscal year 1997. Gross profit as a percentage of sales of x-ray tubes and imaging subsystems was flat at 34% in both fiscal year 1998 and fiscal year 1997, despite production start-up costs for new digital imaging products.

Research and Development. VMS's research and development expenses of $39 million in fiscal year 1998, were 26% higher than the $31 million of such expenses in fiscal year 1997, representing approximately 7% of sales in both fiscal years 1998 and 1997. The increase on an absolute basis was primarily attributable to the Company's investments in new digital radiographic imaging products, new oncology administrative and imaging software, improvements in oncology systems multileaf collimator products and new x-ray tube platforms.

Selling, General and Administrative. VMS's selling, general and administrative expenses of $118 million were 22% of sales in fiscal year 1998, compared to $100 million, or 21% of sales, in fiscal year 1997. The increase, in absolute terms, resulted from the acquisition of a Japanese distributor, higher international



commission expenses, the expansion of VMS's sales and marketing forces and amortization of goodwill and trade receivables write-offs.

Taxes on Earnings. The Company's effective tax rate was 27% in fiscal year 1998, compared to 31.5% in fiscal year 1997. The fiscal year 1998 and fiscal year 1997 rates were lower than the U.S. federal statutory rate due to the tax benefits arising from the use of a foreign sales corporation. In addition, the fiscal year 1998 rate was lower than the fiscal year 1997 rate due to the impact of higher earnings in low-tax foreign countries.

Net Earnings. The Company's net earnings from continuing operations in fiscal year 1998 were $26 million, or 4.8% of sales, an increase of 31% over the $20 million of net earnings, or 4% of sales, in fiscal year 1997. The increase in net earnings was primarily the result of increased sales volume.

Liquidity and Capital Resources

Prior to the Distribution, the Company historically incurred or managed debt at the parent level. Under the Distribution Agreement, (1) the Company was required to contribute to VSEA such cash and cash equivalents so that VSEA would have $100 million in cash and cash equivalents, net worth (as defined in the Distribution Agreement) of at least $150 million and consolidated debt (as defined in the Distribution Agreement) of no more than $5 million and (2) VI was required to assume 50% of the outstanding indebtedness under the Company's term loans and have transferred to it such portion of the indebtedness under the Company's notes payable and such amount of cash and cash equivalents so that as of the time of the Distribution, VMS and VI would each have net debt (defined in the Distribution Agreement as the amount outstanding under the term loans and the notes payable, less cash and cash equivalents) equal to approximately 50% of the net debt of the Company. As a result, the Company transferred $119 million in cash and cash equivalents to VSEA and VI, and VSEA and VI assumed $69 million in debt. Certain future adjustments or payments may be required under the provisions of the Distribution Agreement or the Distribution Related Agreements. VMS may be required to make cash payments to VI or VSEA, or may be entitled to receive cash payments from VI or VSEA. The amounts of such adjustments, if any, are not expected to be material.

At October 1, 1999, long-term debt amounted to $58.5 million of term loans and $35.6 million of short-term notes payable. Interest rates on the Company's outstanding term loans on this date ranged from 6.70% to 7.15% and the weighted average interest rate on these term loans was 6.82%. As of October 1, 1999, the weighted average interest rate on the Company's notes payable was 6.1%. The term loans contain covenants that limit future borrowings and the payment of cash dividends and require the maintenance of certain levels of working capital and operating results.

At October 1, 1999, the Company had $25.1 million in cash and cash equivalents, the majority of which was held abroad, compared to $149.7 million

at October 2, 1998. Operating activities used cash of $33.6 million in fiscal year 1999, compared to providing cash of $127.8 million in fiscal year 1998 and $44.9 in fiscal year 1997. The largest difference between fiscal year 1998 and fiscal year 1999 relates to the decrease in net income, including discontinued operations, from a $24.2 million loss in fiscal year 1999, compared to $73.8 million in earnings in fiscal year 1998. Operating activities provided cash of $127.8 million in fiscal year 1998 compared to $44.9 million in fiscal year 1997. The increase in cash provided by operating activities was due primarily to a decrease in accounts receivable. Investing activities provided $12.9 million of cash in fiscal year 1999, including the proceeds of $54.3 million from the sale of the Company's long-term leasehold interests in certain of its Palo Alto facilities, related buildings and certain other corporate assets, which was partially offset by $39.4 million used to purchase property, plant and equipment. In contrast, investing activities in fiscal year 1998 used $143.1 million of cash, with $47.0 million used to purchase property, plant and equipment and $105.5 million used to acquire businesses, including the purchase of the RS Business. Investing activities in fiscal year 1997 provided $49.7 million of cash, including $145.5 million in proceeds from the sale of VSEA's Thin Film System business, partially offset by $34.3 million used to purchase various businesses and $55.1 to purchase property and equipment. Financing activities, primarily the aggregate of $119.3 million contributed to VI and VSEA in connection with the Distribution, somewhat offset by $15.7 million in proceeds received from employees to



purchase common stock, used net cash of $104.7 million in fiscal year 1999. Financing activities in fiscal year 1998 provided $19.3 million of cash. Additional long-term borrowings of $38.0 million and net borrowings of $27.6 million on short-term obligations were offset by $34.5 million used to repurchase shares of the Company's stock (net of $19.7 million of proceeds received from employees to purchase common stock) and $14.3 million used to pay dividends. Financing activities in fiscal year 1997, in which the Company increased long-term borrowings by $25.0 million, used $40.0 million of cash. In fiscal year 1997, the Company used $56.5 million to repurchase shares of the Company's stock (net of $38.2 million of proceeds received from employees to purchase common stock) and $10.4 million to pay dividends.

Total debt as a percentage of total capital increased to 33.7% at fiscal year end 1999 from 22.1% at fiscal year end 1998. The ratio of current assets to current liabilities was 1.42 to 1 at fiscal year end 1999 compared to 1.66 to 1 at fiscal year end 1998. VMS had $78.2 million available in unused, uncommitted lines of credit at October 1, 1999. Following the end of fiscal year 1999, VMS added an additional $50 million committed revolving credit facility.

VMS expects that its future capital expenditures will continue to approximate 2.5% of sales in each fiscal year. The Company anticipates spending less than $1 million to complete the split of the jointly owned information technology infrastructure and $2.7 million in spin-related capital expenditures related to changes in facilities during the first three quarters of fiscal year 2000. Further, in May 1999, the VMS agreed to invest $5 million over the following twelve months in a consortium to participate in the consortium's acquisition of a majority interest in an entity that supplies VMS with amorphous silicon thin-film transistor arrays for its imaging products of which $2.5 million was funded in July 1999, and of which $2.5 million will be funded in fiscal year 2000 and VMS may recognize a loss beginning in fiscal year 2000 or in future fiscal years of up to $5 million on its equity investment.

The Company is a party to three related federal actions involving claims by independent service organizations ("ISOs") that the Company's policies and business practices relating to replacement parts violate the antitrust laws (the "ISOs Litigation"). The ISOs purchase replacement parts from VMS and compete with it for the servicing of linear accelerators made by VMS. In response to several threats of litigation regarding the legality of VMS's parts policy, the Company filed a declaratory judgment action in a U.S. District Court in 1996 seeking a determination that its new policies are legal and enforceable and damages against two of the ISOs for misappropriation of VMS's trade secrets, unfair competition, copyright infringement and related claims. Subsequently, four of the defendants filed separate claims in other jurisdictions raising issues allegedly related to those in the declaratory relief action and seeking injunctive relief against the Company and damages against the Company in the amount of $10 million for each plaintiff. The defendants' motion for a preliminary injunction in U.S. District Court in Texas with respect to the VMS's policies was defeated. The ISOs defendants amended the complaint to include class action allegations, allege a variety of other anti-competitive business practices and filed a motion for class certification, which was heard by the U.S. District Court in Texas in July 1999. No decision, however, has been entered.

Following the Distribution, VMS retained the liabilities related to the medical systems business prior to the Distribution, including the ISOs Litigation. In addition, under the terms of the Distribution Agreement, the Company agreed to manage and defend liabilities related to legal proceedings and environmental matters arising from corporate or discontinued operations of the Company prior to the Distribution. Under the terms of the Distribution

Agreement, VI and VSEA generally are each obligated to indemnify VMS for one-third of these liabilities (after adjusting for any insurance proceeds realized or tax benefits recognized by VMS), including certain environmental-related liabilities described below, and to fully indemnify VMS for liabilities arising from the operations of the business transferred to each prior to the Distribution. The availability of such indemnities will depend upon the future financial strength of VI and VSEA. No assurance can be given that the relevant company will be in a position to fund such indemnities. It is also possible that a court would disregard this contractual allocation of indebtedness, liabilities and obligations among the parties and require VMS to assume responsibility for obligations allocated to another party, particularly if such other party were to refuse or was



unable to pay or perform any of its allocated obligations. In addition, the Distribution Agreement generally provides that if a court prohibits a company from satisfying its indemnification obligations, then such indemnification obligations will be shared equally between the two other companies.

VMS is also involved in certain other legal proceedings arising in the ordinary course of its business. While there can be no assurances as to the ultimate outcome of any litigation involving VMS, management does not believe any pending legal proceeding will result in a judgment or settlement that will have a material adverse effect on the VMS's financial position, results of operations or cash flows.

VMS's liquidity is affected by many factors, some related to the normal ongoing operations of the business and others related to the markets for its products and conditions in the U.S. and global economies generally. Although the Company's cash requirements will fluctuate as a result of the shifting influence of these factors, management believes that existing cash, cash generated from operations and the Company's borrowing capability will be sufficient to satisfy anticipated commitments for capital expenditures and other cash requirements for fiscal year 2000.

Recent Accounting Pronouncements

In June 1998, the Financial Accounting and Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS 133 requires derivatives to be measured at fair value and to be recorded as assets or liabilities on the balance sheet. The accounting for gains or losses resulting from changes in the fair values of those derivatives would be dependent upon the use of the derivative and whether it qualifies for hedge accounting. SFAS 133 is effective for VMS's fiscal year 2001. VMS has not yet determined the impact of its implementation on the Company's consolidated financial statements.

Environmental Matters

VMS's operations are subject to various foreign, federal, state and/or local laws regulating the discharge of materials into the environment or otherwise relating to the protection of the environment. This includes discharges into soil, water and air, and the generation, handling, storage, transportation and disposal of waste and hazardous substances. In addition, several countries are reviewing proposed regulations that would require manufacturers to dispose of their products at the end of a product's useful life. These laws have the effect of increasing costs and potential liabilities associated with the conduct of such operations.

The Company has been named by the U.S. Environmental Protection Agency or third parties as a potentially responsible party under the Comprehensive Environmental Response Compensation and Liability Act of 1980, as amended ("CERCLA"), at nine sites where Varian is alleged to have shipped manufacturing waste for recycling or disposal. The Company is also involved in various stages of environmental investigation and/or remediation under the direction of, or in consultation with, federal, state and/or local agencies at certain current VMS or former Varian facilities (including facilities disposed of in connection with the Company's sale of its Electron Devices business during 1995, and the sale of its Thin Film Systems business during 1997). Under the terms of the Distribution Agreement, VI and VSEA are each obligated to indemnify VMS for one-third of these environmental-related investigation and remediation costs (after adjusting for any insurance proceeds realized or tax benefits recognized by the Company). Expenditures for environmental investigation and remediation amounted to $0.9 million in fiscal year 1999, $1.7 million in fiscal year 1998 and $0.8 million in fiscal year 1997, net of amounts that were, or would have been, borne by VI and VSEA.

For certain of these sites and facilities, various uncertainties make it difficult to assess the likelihood and scope of further investigation or remediation activities or to estimate the future costs of such activities if undertaken. As of October 1, 1999, VMS nonetheless estimated that VMS's future exposure (net of VI and VSEA's indemnification obligations) for environmental-related investigation and remediation costs for these sites ranged in the aggregate from $12.4 million to $29.8 million. The time frame over which the Company expects to

incur such costs varies with each site, ranging up to approximately 30 years as of October 1, 1999. Management believes that no amount in the foregoing range of estimated future costs is more probable of being incurred than any other amount in such range and therefore accrued $12.4 million in estimated environmental costs as of October 1, 1999. The amount accrued has not been discounted to present value.

As to other sites and facilities, VMS has gained sufficient knowledge to be able to better estimate the scope and costs of future environmental activities. As of October 1, 1999, VMS estimated that VMS's future exposure (net of VI and VSEA's indemnification obligations) for environmental-related investigation and remediation costs for these sites and facilities ranged in the aggregate from $22.9 million to $39.0 million. The time frame over which these costs are expected to be incurred varies with each site and facility, ranging up to approximately 30 years as of October 1, 1999. As to each of these sites and facilities, management determined that a particular amount within the range of estimated costs was a better estimate of the future environmental liability than any other amount within the range, and that the amount and timing of these future costs were reliably determinable. Together, these amounts totaled $26.7 million at October 1, 1999. VMS accordingly accrued $11.9 million, which represents its best estimate of the future costs discounted at 4%, net of inflation. This accrual is in addition to the $12.4 million described in the preceding paragraph.

At October 1, 1999, the Company's reserve for environmental liabilities, based upon future environmental related costs estimated by the Company as of that date, was calculated as follows:

| | Recurring Costs | Non-Recurring Costs | Total Anticipated Future costs |
|---|---|---|---|
| | (Dollars in millions) | | |
| Fiscal Year: | | | |
| 2000 | $ 1.2 | $2.8 | $ 4.0 |
| 2001 | 1.3 | 1.1 | 2.4 |
| 2002 | 1.4 | 0.0 | 1.4 |
| 2003 | 1.3 | 0.0 | 1.3 |
| 2004 | 1.4 | 0.0 | 1.4 |
| Thereafter | 27.2 | 1.4 | 28.6 |
| Total costs | $33.8 | $5.3 | 39.1 |
| Less imputed interest | | | (14.8) |
| Reserve amount | | | $ 24.3 |

The amounts set forth in the foregoing table are only estimates of anticipated future environmental-related costs, and the amounts actually spent may be greater or less than such estimates. The aggregate range of cost estimates reflects various uncertainties inherent in many environmental investigation and remediation activities and the large number of sites and facilities involved. VMS believes that most of these cost ranges will narrow as investigation and remediation activities progress. VMS believes that its reserves are adequate, but as the scope of its obligations becomes more clearly defined, these reserves (and the associated indemnification obligations of VI and VSEA) may be modified and related charges against earnings may be made.

Although any ultimate liability arising from environmental-related matters described herein could result in significant expenditures that, if aggregated and assumed to occur within a single fiscal year, would be material to VMS's financial statements, the likelihood of such occurrence is considered remote. Based on information currently available to management and its best assessment of the ultimate amount and timing of environmental-related events (and assuming VI and VSEA satisfy their indemnification obligations), management believes that the costs of these environmental related matters are not reasonably likely to have a material adverse effect on the consolidated financial statements of VMS.

VMS evaluates its liability for environmental-related investigation and remediation in light of the liability and financial wherewithal of potentially responsible parties and insurance companies with respect to which VMS believes that it has rights to contribution, indemnity and/or reimbursement (in addition to the obligations of VI



and VSEA). Claims for recovery of environmental investigation and remediation costs already incurred, and to be incurred in the future, have been asserted

against various insurance companies and other third parties. In 1992, the Company filed a lawsuit against 36 insurance companies with respect to most of the above-referenced sites and facilities. The Company received certain cash settlements during fiscal years 1995, 1996, 1997 and 1998 from defendants in that lawsuit. The Company has also reached an agreement with another insurance company under which the insurance company has agreed to pay a portion of the Company's past and future environmental-related expenditures, and VMS therefore has a $3.6 million receivable in Other Assets at October 1, 1999. VMS believes that this receivable is recoverable because it is based on a binding, written settlement agreement with a solvent and financially viable insurance company. Although VMS intends to aggressively pursue additional insurance and other recoveries, VMS has not reduced any liability in anticipation of recovery with respect to claims made against third parties.

Varian's present and past facilities have been in operation for many years, and over that time in the course of those operations, such facilities have used substances which are or might be considered hazardous, and Varian has generated and disposed of wastes which are or might be considered hazardous. Therefore, it is possible that additional environmental issues may arise in the future that VMS cannot now predict.

Year 2000

General. The "Year 2000" problem refers to computer programs and other equipment with embedded microprocessors ("non-IT systems") which use only the last two digits to refer to a year, and which, therefore, might not properly recognize a year that begins with "20" instead of the familiar "19." As a result, those computer programs and non-IT systems might be unable to operate or process accurately certain date-sensitive data before or after January 1, 2000. Because VMS relies heavily on computer programs and non-IT systems, and relies on third parties which themselves rely on computer programs and non-IT systems, the Year 2000 problem, if not addressed, could adversely effect VMS's business, results of operations or financial condition.

State of Readiness. VMS previously initiated a comprehensive assessment of potential Year 2000 problems with respect to (1) the Company's internal system, (2) the Company's products and (3) significant third parties with which the Company does business.

VMS has substantially completed its assessment of potential Year 2000 problems in internal systems, which systems have been categorized as follows, in order of importance: (a) enterprise information systems; (b) enterprise networking and telecommunications; (c) factory-specific information systems; (d) non-IT systems; (e) computers and packaged software; and (f) facilities systems. Upgrade of (a) enterprise information systems, (b) enterprise networking and telecommunications and item (f) facilities, is complete. As of October 1, 1999, upgrade of factory specific information was 94% complete; upgrade of non-IT systems was 95% complete, and upgrade of computers and packaged software was 95% complete. The Company expects the upgrade of remaining items to be essentially complete prior to the end of December 1999.

VMS also initiated an assessment of potential Year 2000 problems in its current and previously-sold products. With respect to current products, that assessment and corrective actions are substantially complete, and VMS believes that all of its current products are Year 2000 capable; however, that conclusion is based in part on Year 2000 assurances or warranties from suppliers of computer programs and non-IT systems which are integrated into or sold with VMS's current products.

With respect to previously-sold products, VMS focused its assessments on products that are subject to regulatory requirements with respect to Year 2000, including FDA requirements for medical devices, rather than assessing Year 2000 preparedness of every product it has ever sold. VMS also focused its assessments on products that will be under written warranties or are still relatively early in their useful lives, are more likely to be dependent on non-IT systems that are not Year 2000 capable and cannot be easily upgraded with readily available externally-utilized computers and packaged software and/or could pose a safety hazard. Where these now completed assessments identified previously-sold products that were not Year 2000 capable, VMS in some cases developed and offered to sell upgrades or retrofits, identify corrective measures which the customer could



itself undertake or identify for the customer other suppliers of upgrades or retrofits. For a few products VMS decided to perform upgrades at its own expense. These costs have not been material. Remaining upgrades are expected to be completed before December 31, 1999.

The Company has substantially completed assessing the potential Year 2000 problems of third parties with which VMS has material relationships, which are primarily suppliers of products or services. These assessments identified and prioritized critical suppliers, reviewed those suppliers' written assurances on their own assessments and correction of Year 2000 problems, and developed appropriate contingency plans for those suppliers which might not be adequately prepared for Year 2000 problems.

Costs. VMS estimates that through October 1, 1999 it had incurred

approximately $1.1 million to assess and correct Year 2000 problems. VMS estimates that it will incur approximately $100,000 in additional costs to assess and correct Year 2000 problems, which costs are expected to be incurred in the first half of fiscal year 2000. All of these costs, except for approximately $70,000 for computer equipment, have been and will continue to be expensed as incurred.

This estimate of future costs has not been reduced by expected recoveries from certain third parties, which are subject to indemnity, reimbursement or warranty obligations for Year 2000 problems. In addition, VMS expects that certain costs may be offset by revenues generated by the sale of upgrades and retrofits and other customer support services relating to Year 2000 problems. However, there can be no assurance that VMS's actual costs to assess and correct Year 2000 problems will not be higher than the foregoing estimates.

Risks. Failure by VMS and its key suppliers to accurately assess and correct Year 2000 problems, would likely result in interruption of certain of VMS's normal business operations, which could have a material adverse effect on VMS's business, results of operations or financial condition. If VMS does not adequately identify and correct Year 2000 problems in its information systems, it could experience an interruption in its operations, including manufacturing, order processing, receivables collection and accounting, such that there would be delays in product shipments, lost data and a consequential impact on revenues, expenditures and financial reporting. If VMS does not adequately identify and correct Year 2000 problems in its non-IT systems, it could experience an interruption in its manufacturing and related operations, such that there would be delays in product shipments and a consequential impact on revenues. If VMS does not adequately identify and correct Year 2000 problems in previously-sold products, it could experience warranty or product liability claims by users of products which do not function correctly. If VMS does not adequately identify and correct Year 2000 problems of the significant third parties with which it does business, it could experience an interruption in the supply of key components or services from those parties, such that there would be delays in product shipments or services and a consequential impact on revenues.

Management believes that appropriate corrective actions have been or will be accomplished within the cost and time estimates stated above. Although VMS does not expect to be 100% Year 2000 compliant by December 31, 1999, VMS does not currently believe that any Year 2000 non-compliance in VMS's information systems would have a material adverse effect on VMS's business, results of operations or financial condition. However, given the inherent complexity of the Year 2000 problem, there can be no assurance that actual costs will not be higher than currently anticipated or that corrective actions will not take longer than currently anticipated to complete. Risk factors which might result in higher costs or delays include the ability to identify and correct in a timely fashion Year 2000 problems; regulatory or legal obligations to correct Year 2000 problems in previously-sold products including the risk of product recall; possible liability for personal injury if a safety hazard relating to Year 2000 is not identified and corrected; ability to retain and hire qualified personnel to perform assessments and corrective actions; the willingness and ability of critical suppliers to assess and correct their own Year 2000 problems, including in products they supply to VMS; and the additional complexity which will likely be caused by undertaking during fiscal year 1999 and fiscal year 2000 the separation of currently shared enterprise information systems as a result of the Distribution.

Because of uncertainties as to the extent of Year 2000 problems with VMS's previously-sold products and the extent of any legal obligation of VMS to correct Year 2000 problems in those products, VMS cannot yet



assess risks to VMS with respect to those products. Because its assessments are not yet complete, VMS also cannot yet conclude that the failure of critical suppliers to assess and correct Year 2000 problems is not reasonably likely to have a material adverse effect on VMS's results of operations. Failure of VMS' customers to pay receivables in a timely manner due to their own year 2000 problems could result in delays in payments and slower cash flow.

Contingency Plans. With respect to VMS's enterprise information systems, VMS has executed its contingency plan. That plan primarily involved installation where necessary of a Year 2000 capable upgrade of existing information systems pending complete installation of the SAP system. That upgrade is complete. With respect to products and significant third parties, VMS intends, as part of its on-going assessment of potential Year 2000 problems, to develop contingency plans for the more critical problems that might not be corrected before December 31, 1999. It is currently anticipated that the focus of these contingency plans will be the possible interruption of the supply of key components or services from third parties.

Certain Factors Affecting the Company's Business

The following factors, in conjunction with the other information included in this Annual Report, should be carefully considered.

Lack of Recent Operating History as Separate Entity

VMS is a smaller and less diversified company than Varian was prior to the Distribution. The Company now owns and operates only the medical systems business, which does not have a recent operating history as a separate entity. The ability of VMS to satisfy its obligations and maintain profitability is now solely dependent upon the future performance of this business. Although VMS is now managed by its prior operating management, the management of VMS did not operate its business as a separate public company prior to the Distribution.

Debt Leverage after the Distribution

Since the Distribution, VMS has had somewhat greater debt leverage than Varian had prior to the Distribution. As of October 1, 1999, Varian had total long and short-term debt of approximately $94 million and total stockholders' equity of approximately $185 million.

The degree to which VMS is leveraged could have important consequences, including the following: (i) VMS's ability to obtain additional financing in the future for working capital, capital expenditures, product development, acquisitions, general corporate purposes or other purposes may be impaired; (ii) a portion of VMS's and its subsidiaries' cash flow from operations must be dedicated to the payment of the principal and interest on its indebtedness; (iii) the term loans of VMS contain certain restrictive financial and operating covenants, including, among others, requirements that VMS satisfy certain financial ratios; (iv) a portion of VMS's borrowings are at floating rates of interest, causing VMS to be vulnerable to increases in interest rates; (v) VMS's degree of leverage may make it more vulnerable in a downturn in general economic conditions and (vi) VMS's degree of leverage may limit its flexibility in responding to changing business and economic conditions. In addition, in a lawsuit by an unpaid creditor or representative of creditors, such as a trustee in bankruptcy, a court may be asked to void the Distribution (in whole or in part) as a fraudulent conveyance and to require that the stockholders return some or all of the shares of VSEA common stock and/or VI common stock to VMS or require each of VMS, VSEA or VI to fund certain liabilities of the other companies for the benefit of creditors.

Federal Income Tax Considerations

The Company received a Tax Ruling from the Internal Revenue Service (the "IRS") in connection with the Distribution to the effect that, among other things, no gain or loss would be recognized by the holders of Varian common stock as a result of the Distribution and no gain or loss would be recognized by the Company upon the



Distribution. Such rulings, while generally binding upon the IRS, are subject to certain factual representations and assumptions. If such factual representations and assumptions were incorrect in any material respect, such ruling would be jeopardized. VMS is not aware of any facts or circumstances that would cause such representations and assumptions to be untrue. Varian, VI and VSEA have agreed to certain restrictions on their future actions to provide further assurances that the Distribution will qualify as tax-free.

If one or both of the distributions comprising the Distribution failed to qualify as a tax-free spin-off under Section 355 of the Internal Revenue Code of 1986, as amended (the "Code"), then the Company will recognize gain equal to the difference between the fair market value of the stock of the nonqualifying company or companies and the Company's adjusted tax basis in such stock. If the Company were to recognize gain on one or both of the distributions, such gain and the resulting tax liability likely would be very substantial.

Section 355(e), which was added to the Code in 1997, generally provides that a company that distributes shares of a subsidiary in a spin-off that is otherwise tax-free will incur federal income tax liability if 50% or more, by vote or value, of the capital stock of either the company making the distribution or the spun-off subsidiary is acquired (a "50% Ownership Shift") by one or more persons acting pursuant to a plan or series of related transactions that includes the spin-off. There is a presumption that any acquisition of 50% or more, by vote or value, of the capital stock of the company or the subsidiary that occurs within two years before or after the spin-off is pursuant to a plan that includes the spin-off. However, the presumption may be rebutted by establishing that the spin-off and the acquisition are not part of a plan or series of related transactions. Among the factual representations made by the Company to the IRS in connection with the Tax Ruling is the representation that each of the distributions was not part of such a plan or series of related transactions. If VMS, VI or VSEA were to undergo a 50% Ownership Shift, particularly if such 50% Ownership Shift occurred within two years after the date of the Distribution, there can be no assurance that the IRS will not assert that such ownership shift occurred pursuant to a plan or series of related transactions and therefore that the Distribution is taxable under Section 355(e).

If a distribution is taxable solely under Section 355(e), the Company would recognize gain equal to the difference between the fair market value of the VSEA common stock and VI common stock and the Company's adjusted tax basis in

such stock. However, holders of Varian common stock on the Distribution would not recognize gain or loss as a result of the Distribution. If the Company were to recognize gain on the distributions, such gain and the resulting tax liability likely would be very substantial.

The Tax Sharing Agreement allocates responsibility for the possible corporate tax burden resulting from the Distribution. Each of VMS, VI and VSEA are responsible for any corporate taxes resulting from the Distribution attributable to action taken or permitted by that entity or its affiliates after the Distribution. If the Distribution is found to be taxable but none of VMS, VI and VSEA has done anything to cause the Distribution to be taxable, each company generally will be liable for one-third of those taxes.

Certain Anti-takeover Features

VMS has a stockholder rights plan which, under certain circumstances, would significantly dilute the equity interest in VMS of persons seeking to acquire control of VMS without the prior approval of its Board of Directors. Certain provisions of VMS's Certificate of Incorporation may make more difficult an acquisition of control of VMS without the approval of its Board of Directors.

Fraudulent Transfer Considerations; Legal Dividend Requirements

If a court in a lawsuit by an unpaid creditor or representative of creditors, such as a trustee in bankruptcy, were to find that at the time Varian effected the Distribution, the Company, VSEA or VI, as the case may be, (i) was insolvent, (ii) was rendered insolvent by reason of the Distribution, (iii) was engaged in a business or transaction for which the Company's, VSEA's or VI's, as the case may be, remaining assets constituted unreasonably small capital or (iv) intended to incur, or believed it would incur, debts beyond its ability to pay such debts as they matured, such court may be asked to void the Distribution (in whole or in part) as a fraudulent



conveyance and require that the stockholders return some or all of the shares of VSEA common stock and VI common stock to the Company, or require the Company, VSEA or VI, as the case may be, to fund certain liabilities of the other companies for the benefit of creditors. The measure of insolvency for purposes of the foregoing will vary depending upon the jurisdiction whose law is being applied. Generally, however, each of the Company, VSEA and VI, as the case may be, would be considered insolvent if the fair value of its assets were less than the amount of its liabilities or if it incurred debt beyond its ability to repay such debt as it matures. In addition, under Section 170 of the Delaware General Corporation Law (the "DGCL") (which was applicable to the Distribution), a corporation generally may make distributions to its stockholders only out of its surplus (net assets minus capital) and not out of capital.

Transitioning to New Information Technology Infrastructures

At the time of the Distribution, VMS, VI and VSEA shared a common information technology ("IT") infrastructure that was essential to the daily operation of the companies' marketing, manufacturing, distribution, billing and collections and financial reporting processes.

VMS will establish a separate IT infrastructure as appropriate for its business and will transition to this new IT infrastructure from the currently shared IT infrastructure. VMS will continue to provide certain IT services to each of VSEA and VI pursuant to the Transition Services Agreement until the separation of the IT infrastructure is complete. These transitions are not unlike transitions carried out previously by Varian in the process of divesting discontinued operations and/or integrating the operations of newly acquired companies. Consequently, management of VMS believes that it possesses the skills and resources to design, implement and transition to VMS's new IT infrastructure, while at the same time assisting each of VSEA and VI in transitioning to their new IT infrastructures. However, these activities are inherently complex and because of their significance to VMS's business, unforeseen problems or errors in VMS's transition to its new IT infrastructure could adversely affect the business and results of operations of VMS. Assessment and correction of Year 2000 problems could complicate transition to these new infrastructures.

Uncertain Market Acceptance of Products; Product Obsolescence

There can be no assurance that VMS's future products will gain any significant market acceptance and market share among physicians, patients and health care payors, even if required regulatory approvals are obtained. Market acceptance may depend on a variety of factors, including educating physicians regarding the use of a new procedure, overcoming physician objections to certain effects of the product or its related treatment regimen and convincing health care payors that the benefits of the product and its related treatment regimen outweigh its costs. Market acceptance and market share are also affected by the timing of market introduction of competitive products. Accordingly, the relative speed with which VMS can develop products, gain regulatory approval and reimbursement acceptance and supply commercial quantities of the product to the market are expected to be important factors in market acceptance and market share.

In addition, the marketplace for medical products is characterized by rapid change and technological innovation. As a result, VMS is subject to the risk of product obsolescence, whether from long development or government approval cycles or the development of improved products or processes by competitors. In addition, the marketplace could conclude that the task for which VMS's product was designed is no longer an element of a generally accepted diagnostic or treatment regimen. Any development adversely affecting the market for equipment manufactured by VMS would result in its having to reduce production volumes or to discontinue manufacturing, which could have an adverse effect on VMS's business, results of operations and financial condition. There can be no assurance that VMS's products or proprietary technologies will not become uncompetitive or obsolete.

Technological Change and New Products

The market for VMS's products is characterized by rapid and significant technological change, evolving industry standards and new product introductions. Many of VMS's products are technologically innovative and



require significant planning, design, development and testing at the technological, product and manufacturing process levels. These activities require significant capital commitments and investment by VMS.

New product developments and new business opportunities in the health care industry have inherent risks and unpredictability. These include proof of feasibility; time required from proof of feasibility to routine production; timing and cost of regulatory approvals; inventory overruns caused by phase-in of new products and phase-out of old products; manufacturing, installation, warranty and maintenance cost overruns; customer acceptance and payment; customer demands for retrofits of both new and old products; and reaction of competitors. There can be no assurance that VMS will successfully develop, manufacture and phase in new products or that quarterly or yearly financial performance dependent upon new product introductions will not be materially adversely affected.

The high cost of technological innovation is matched by the rapid and significant change in the technologies governing the products that are competitive in VMS's market, by industry standards that may change on short notice and by the introduction of new products and technologies which may render existing products and technologies uncompetitive. If VMS does not successfully introduce new products, VMS's results of operations will be materially adversely affected.

Government Regulation

VMS's products and manufacturing activities are subject to extensive and rigorous government regulation, including the provisions of the U.S. Food and Drug Act. Commercial distribution in certain foreign countries is also subject to government regulation. The process of obtaining required regulatory approvals can be lengthy, expensive and uncertain. Moreover, regulatory approvals, if granted, may include significant limitations on the indicated uses for which a product may be marketed. The FDA actively enforces regulations prohibiting marketing of medical devices without compliance with certain pre-market approval provisions. A Section 510(k) application is required in order to market a new or modified medical device, and if specifically required by the FDA, a pre-market approval application, which is often more costly to obtain, may be necessary. The FDA review process typically requires extended proceedings pertaining to the safety and efficacy of new products, which may delay or hinder a product's timely entry into the marketplace. The FDA and the U.S. Federal Trade Commission also regulate the content of advertising and marketing materials relating to medical devices. There can be no assurance that VMS's advertising and marketing materials regarding its products are and will be in compliance with such regulations.

VMS is also subject to other federal, state, local and foreign laws, regulations and recommendations relating to medical devices, safe working conditions and laboratory and manufacturing practices. Failure to comply with applicable regulatory requirements can result in, among other things, fines, suspensions of approvals, seizures or recalls of products, operating restrictions and criminal prosecutions. Furthermore, changes in existing regulations or adoption of new regulations could affect the timing of, or prevent VMS from obtaining, future regulatory approvals. The effect of government regulation may be to delay for a considerable period of time or to prevent the marketing and full commercialization of future products or services that VMS may develop, and/or to impose costly requirements on VMS. There can also be no assurance that additional regulations will not be adopted or current regulations amended in such a manner as will materially adversely affect VMS.

Uncertainty of Health Care Reform

The U.S. government has in the past, and may in the future, consider (and certain state and local as well as a number of foreign governments are considering or have adopted) health care policies intended to curb rising health care costs. Such policies include rationing of government-funded

reimbursement for health care services and imposing price controls on providers of medical products and services. VMS cannot predict what health care reform legislation or regulation, if any, will be enacted in the United States or elsewhere. Significant changes in the health care systems in the United States or elsewhere would likely have a significant impact on the demand for VMS's products and services and the manner in which VMS conducts its business. VMS is unable to predict



whether such proposals will be enacted, whether other health care legislation or regulation affecting VMS's business, financial condition and results of operations may be proposed or enacted in the future, or what effect any such legislation or regulation would have on VMS's business, financial condition and results of operations.

Uncertainty of Third-Party Reimbursement

Sales of certain products manufactured by VMS are indirectly dependent in part on the availability to VMS's customers of adequate reimbursement for the treatment provided by those products from third-party health care payors, such as government and private insurance plans, health maintenance organizations and preferred provider organizations, in that the availability of such reimbursement affects VMS's customers' capital equipment purchasing decisions. Third-party payors are increasingly challenging the pricing of medical procedures. There can be no assurance that adequate levels of reimbursement to VMS's customers will be available to enable VMS to achieve or maintain sales and pricing demands for of its products. Without adequate support from third-party payors, the market for the products of VMS may be limited. There is no uniform policy on reimbursement among third-party payors, nor are there any assurances that procedures using VMS's products will qualify for reimbursement from third-party payors. Foreign countries also have their own health care reimbursement systems, and there can be no assurance that third-party reimbursement will be made available with respect to VMS's products under any foreign reimbursement system.

In addition, VMS's business, financial condition and results of operations could be adversely affected by the continuing efforts of many third-party payors to reduce the costs of health care by decreasing reimbursement rates, or limiting or prohibiting reimbursement for certain services or devices or through other means. Furthermore, legislative proposals to reform government health care insurance programs, including the Medicare and Medicaid programs, could significantly impact the purchase of health care services and products and could result in lower prices and reduced demand for VMS's products. VMS is unable to predict whether such proposals will be enacted, whether other health care legislation or regulation affecting VMS's business, financial condition and results of operations may be proposed or enacted in the future, or what effect any such legislation or regulation would have on VMS's business, financial condition and results of operations.

Product Recalls, Product Liability and Insurance

The tolerance for error in the design, manufacture or use of VMS's systems may be small or nonexistent. If a system designed or manufactured by VMS is found to be defective, whether due to design or manufacturing defects, to improper use of the system or to other reasons, the system may need to be recalled, possibly at VMS's expense. Furthermore, the adverse effect of a product recall on VMS might not be limited to the cost of the recall. For example, a product recall could cause a general investigation of VMS by applicable regulatory authorities as well as cause other customers to review and potentially terminate their relationships with VMS. Recalls, especially if accompanied by unfavorable publicity or termination of customer contracts, could result in substantial costs, loss of revenues and a diminution of VMS's reputation, each of which could have a material adverse effect on VMS's business, results of operations and financial condition.

The manufacture and sale of medical products manufactured by VMS involve the risk of product liability claims and expose VMS to substantial liability to patients for damages resulting from the faulty design or manufacture of products. Because these medical products involve the delivery of radiation to the human body or are involved in diagnostic imaging of the human body, the possibility for significant injury and/or death exists. Therefore, the design, manufacture, sale and service of medical products manufactured by VMS involve the risk of product liability claims and expose VMS to substantial liability to patients for damages resulting from the faulty design, manufacture or servicing of such products.

Varian has historically maintained limited product liability insurance coverage in an amount it deems sufficient for each of its businesses. Such insurance is subject to deductibles and self-insured retentions. Product liability insurance is expensive and in the future may not be available on acceptable terms, in sufficient amounts or may be unavailable. Although VMS has obtained insurance coverage, no assurance can be given as to its adequacy. A successful claim brought against VMS in excess of its insurance coverage or any material claim for

which insurance coverage is denied or limited and for which indemnification is not available could have a material adverse effect on VMS's business, results of operations and financial condition. There can be no assurance that VMS would have sufficient resources to satisfy any liability resulting from these claims.

On December 5, 1997, VMS purchased the RS Business from the General Electric Company. In connection with that transaction, VMS agreed to assume liability for certain product defects and personal injury matters that might arise with respect to RS Business products, and obtained insurance for these matters. The insurance provides that in each annual period VMS is responsible for the first $5,000,000 of expenses or liabilities related to any such claims. VMS has been notified of three potential claims related to these RS Business products for which VMS may have an indemnity obligation.

Customer Concentration; Customer Financing

Historically, VMS has sold a significant proportion of its systems in any particular period to a limited number of customers. Sales to VMS's ten largest customers in fiscal years 1999, 1998 and 1997 accounted for approximately 24%, 24%, and 28% of sales, respectively. The composition of the group comprising VMS's largest customers has varied from year to year. VMS expects that sales of its products to relatively few customers will continue to account for a similar percentage of its net sales in the foreseeable future. Similarly, VMS has significant strategic relationships with a number of key distributors. The termination of these strategic relationships or the loss of a significant customer or any reduction in orders from any significant customer, including reductions due to customer departures from recent buying patterns, market, economic or competitive conditions in the health care industry could adversely affect VMS's business, financial condition and results of operations. In addition, the ongoing consolidation of customers who purchase x-ray tube products from VMS, including the consolidation of such customers into companies that already manufacture x-ray tubes, may adversely affect VMS's business.

Variability of Operating Results

VMS has experienced and expects to continue to experience fluctuations in its quarterly operating results. The timing and amount of revenues are subject to a number of factors that make estimation of revenues and operational results prior to the end of any quarter very uncertain. Many of VMS's products are products that require significant capital expenditures, and the timing of sales of these products could affect VMS's quarterly earnings. A delay in a shipment in any quarter due, for example, to an unanticipated shipment rescheduling, to cancellations by customers or to unexpected manufacturing difficulties experienced by VMS, may cause sales in such quarter to fall significantly below VMS's expectations and may thus adversely affect VMS's operating results for such quarter. Due to the significant size of certain of VMS's product sales, VMS's operating results may also be affected by an unexpected change in a customer's financial solvency or ability to obtain financing for capital expenditures. Further, VMS's quarterly operating results may also vary significantly depending on a number of other factors, including changes in pricing by VMS or its competitors, discount levels, seasonality of revenue, foreign currency exchange rates, the mix of products sold, the timing of the announcement, introduction and delivery of new product enhancements by VMS and its competitors, and general economic conditions. Because certain operating expenses of VMS are based on anticipated capacity levels and a high percentage of VMS's expenses are fixed for the short term, a small variation in the timing of recognition of revenue can cause significant variations in operating results from quarter to quarter. There can be no assurance that any of these factors will not have a material adverse effect on VMS's business or results of operations. In addition, VMS's orders and backlog cannot necessarily be relied upon as an accurate predictor of future revenues as the timing of such revenues is dependent upon completion of customer site preparation and construction, installation scheduling, customer capital budgeting and financing, receipt of applicable regulatory approvals and other factors. Accordingly, there can be no assurance if or when the orders will mature into revenue.

Competition

The markets served by VMS are characterized by rapidly evolving technology, intense competition and pricing pressure. There are a number of companies that currently offer, or are in the process of developing,



products that compete with products offered by VMS. VMS's products and services compete with those of a substantial number of foreign and domestic companies, some with greater resources, financial or otherwise, than VMS, and the rapid technological changes occurring in VMS's markets are expected to lead to the entry of new competitors. VMS's ability to anticipate technological changes and introduce enhanced products on a timely basis will be a significant factor in VMS's ability to expand and remain competitive. Existing competitors' actions and new entrants may have an adverse impact on VMS's sales and profitability. These competitors could develop technologies and products that are more effective than those currently used or marketed by

VMS or that could render VMS's products obsolete or noncompetitive.

International Sales and Manufacturing

The markets in which VMS competes are becoming increasingly globalized. International sales accounted for approximately 54%, 55%, and 52% of VMS's sales in fiscal years 1999, 1998 and 1997, respectively. As a result, VMS's customers increasingly require service and support on a worldwide basis. VMS has manufacturing and research operations in England, Switzerland, Finland and France as well as sales and service offices located throughout Europe, Asia, Latin America and Australia. VMS has invested substantial financial and management resources to develop an international infrastructure to meet the needs of its customers worldwide. VMS intends to continue to expand its presence in international markets. There can be no assurance that VMS will able to compete successfully in the international market or to meet the service and support needs of such customers. International sales are subject to a number of risks, including the following: agreements may be difficult to enforce and receivables difficult to collect through a foreign country's legal system; foreign customers may have longer payment cycles; foreign countries may impose additional withholding taxes or otherwise tax VMS's foreign income, impose tariffs or adopt other restrictions on foreign trade; fluctuations in exchange rates may affect product demand and adversely affect the profitability in U.S. dollars of products and services provided by VMS in foreign markets where payment for VMS's products and services is made in the local currency; U.S. export licenses may be difficult to obtain; and the protection of intellectual property in foreign countries may be more difficult to enforce.

The economic conditions in certain Asian countries began to deteriorate in the third quarter of 1997 and, in certain countries, such conditions continue. VMS derived approximately 19% of its total sales in fiscal 1999 and approximately 16% of its total sales in fiscal 1998 from sales to customers in Asia. Until the Asian economic uncertainty is resolved, VMS could suffer material reductions in revenue.

On January 1, 1999, the Euro was adopted as the national currency of certain members of the European Monetary Union. The existing national currencies of the participating countries will continue to be acceptable until January 1, 2002, after which the Euro will be the sole legal tender for the participating countries. Because VMS sells its products in Europe, the Euro conversion raises several economic and operational issues, such as the modification of information systems to accommodate Euro-denominated transactions, the recalculation of currency risk, the competitive impact of cross-border price transparency, the continuity of material contracts and potential tax and accounting consequences. VMS made changes in its information systems and is able to conduct Euro-denominated transactions (although full information system capability for financial reporting in Euro will not be accomplished until October 2001). VMS does not expect any change in currency risk, due to its existing hedging practices. VMS does not expect any significant competitive impact of price transparency with respect to its systems, due to the fact that most of those systems are sold in customized configurations. Based on VMS's evaluation to date, VMS does not expect the Euro conversion to have a material adverse effect on its business, results of operations or financial condition.

Foreign Currency Risks

The Company has historically entered into forward exchange contracts in respect of the medical systems business to mitigate the effects of operational (sales orders and purchase commitments) and balance sheet exposures to fluctuations in foreign currency exchange rates. Varian's forward exchange contracts generally range from one to three months in original maturity, and no forward exchange contract has an original maturity greater than one year. At October 1, 1999, VMS had forward exchange contracts to sell foreign currencies totaling $94.5 million and to buy foreign currencies totaling $14.5 million.



Uncertain Protection of Patent and Other Proprietary Rights

VMS places considerable importance on obtaining and maintaining copyright and trade secret protection for significant new technologies, products and processes because of the length of time and expense associated with bringing new products through the development process and to the marketplace.

VMS files applications as appropriate for patents covering new products and manufacturing processes. No assurance can be given that patents now owned or that will issue from any pending or future patent applications owned by, or licensed to, VMS, or that the claims allowed under any issued patents, will be sufficiently broad to protect its technology position against competitors. In addition, no assurance can be given that any issued patents owned by, or licensed to, VMS will not be challenged, invalidated or circumvented, or that the rights granted thereunder will provide competitive advantages to it. VMS could incur substantial costs and diversion of management resources in defending itself in suits brought against it or in suits in which it may assert its patent rights against others. If the outcome of any such litigation is unfavorable to VMS, its business and results of operations could be

materially adversely affected. In addition, the laws of some foreign countries do not protect proprietary rights to the same extent as do the laws of the United States.

There may also be pending or issued patents of which VMS is not aware held by parties not affiliated with it that relate to its products or technologies. In the event that a claim relating to proprietary technology or information is asserted against VMS, it may need to acquire licenses to, or contest the validity of, a competitor's proprietary technology. There can be no assurance that any license required under any such competitor's proprietary technology would be made available on acceptable terms or that VMS would prevail in any such contest. If the outcome of any such contest is unfavorable to VMS, its business and results of operations could be materially adversely affected. From time to time, VMS has received notices from, and has issued notices to, third parties alleging infringement of patent or other intellectual property rights relating to their products. Such claims are often, but not always, settled by mutual agreement on a satisfactory basis without litigation.

VMS relies on a combination of copyright, trade secret and other laws, and contractual restrictions on disclosure, copying and transferring title, including confidentiality agreements with their vendors, strategic partners, co-developers, employees, consultants and other third parties, to protect its proprietary rights. There can be no assurance that such protections will prove adequate and that contractual agreements will not be breached, that VMS will have adequate remedies for any such breaches, or that its trade secrets will not otherwise become known to or independently developed by others. VMS has trademarks, both registered and unregistered, that are maintained and enforced to provide customer recognition for its products in the marketplace. There can be no assurance that its trademarks will not be used by unauthorized third parties. VMS also has agreements with third parties that provide for licensing of patented or proprietary technology. These agreements include royalty-bearing licenses and technology cross-licenses.

Environmental Matters

For a discussion of environmental matters, see "--Environmental Matters."

Reliance on Suppliers

Certain of the components and subassemblies included in VMS's products are obtained from a limited group of suppliers, or in some cases a single-source supplier, including the source wires for high dose afterloaders, klystrons for linear accelerators, solid state imaging panels and specialized integrated circuits for imaging subassemblies. The loss of any of these suppliers, including any single-source supplier, would require obtaining one or more replacement suppliers as well as potentially requiring a significant level of product development to incorporate new parts into VMS's products. VMS believes that alternative sources for such components may generally be obtained when necessary, although the need to change suppliers or to alternate between suppliers might cause material delays in delivery or significantly increase its costs. Although VMS has obtained limited



insurance to protect against loss due to business interruption from these and other sources, there can be no assurance that such coverage will be adequate or that such coverage will continue to remain available on acceptable terms, if at all. Although VMS seeks to reduce its dependence on these limited source suppliers, disruptions or loss of certain of these sources, including the ones referenced above, could have a material adverse effect on VMS's business and results of operations and could result in damage to customer relationships.

Dependence on Key Personnel

VMS's future success depends to a significant extent on the continued service of certain of its key managerial, technical and engineering personnel, and its continuing ability to attract, train and retain highly qualified engineering, technical and managerial personnel. Competition for such personnel is intense, particularly in the labor markets around the VMS facilities in Palo Alto, California and Salt Lake City, Utah. The available pool of qualified candidates is limited and there can be no assurance that VMS can retain its key engineering, technical and managerial personnel or that it can attract, train, assimilate or retain other highly qualified engineering, technical and managerial personnel in the future. The loss of any of VMS's key personnel or the inability of VMS to hire, train or retain qualified personnel could have a material adverse effect on VMS's business, results of operations and financial condition.

Risk of Business Interruption

VMS conducts a portion of its activities including manufacturing, administration and data processing at facilities located in seismically active areas that have experienced major earthquakes in the past. VMS carries limited earthquake insurance on its facilities. However, there can be no assurance that such coverage will be adequate or will continue to be available at commercially reasonable rates and terms. In the event of a major earthquake or other disaster affecting VMS's facilities, the operations and operating results of VMS could be adversely affected.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk

Foreign Currency Exchange

As a global concern, VMS faces exposure to adverse movements in foreign currency exchange rates. These exposures may change over time as business practices evolve and could have a material adverse impact on the VMS's financial results. Historically, the Company's primary exposures have related to non-U.S. dollar denominated sales and purchases throughout Europe, Asia, and Australia. The Euro was adopted as a common currency for certain members of the European Monetary Union on January 1, 1999. VMS is evaluating, among other issues, the impact of the Euro conversion on its foreign currency exposure. Based on its evaluation to date, VMS does not expect the Euro conversion to create any change in its currency exposure due to VMS's existing hedging practices.

At the present time, VMS hedges those currency exposures associated with certain assets and liabilities denominated in non-functional currencies and with anticipated foreign currency cash flows. VMS does not enter into forward exchange contracts for trading purposes. The hedging activity undertaken by VMS is intended to offset the impact of currency fluctuations on certain anticipated foreign currency cash flows and certain non-functional currency assets and liabilities. The success of this activity depends upon estimation of balance sheets denominated in various currencies. To the extent that these forecasts are over- or understated during periods of currency volatility, VMS could experience unanticipated currency gains or losses.



VMS's forward exchange contracts generally range from one to three months in original maturity, and no forward exchange contract has an original maturity greater than one year. Forward exchange contracts outstanding, their unrealized gains or losses and their fair values as of the fiscal year-end 1999 are summarized as follows:

| | Fiscal Year-End 1999 | | | |
|---|---|---|---|---|
| | Notional Value Sold | Notional Value Purchased | Unrealized Gain/(Loss) | Fair Value |
| | (Dollars in millions) | | | |
| Australian dollar | $ 5.3 | $ -- | $(0.1) | $(0.1) |
| Brazilian Real | -- | 0.6 | -- | -- |
| British pound | 5.3 | 1.5 | -- | -- |
| Canadian dollar | 6.4 | -- | (0.1) | (0.1) |
| Danish krona | -- | 4.8 | 0.1 | 0.1 |
| Euro dollar | 66.1 | -- | (0.5) | (1.1) |
| Japanese yen | 5.4 | -- | (0.2) | (0.2) |
| Norwegian kroner | 2.5 | -- | (0.1) | (0.1) |
| Swedish krona | 1.8 | -- | (0.1) | (0.1) |
| Swiss franc | -- | 7.6 | 0.2 | 0.2 |
| Thailand baht | 1.7 | -- | 0.2 | 0.1 |
| Totals | $94.5 | $14.5 | $(0.6) | $(1.3) |

The fair value of forward exchange contracts generally reflects the estimated amounts that VMS would receive or pay to terminate the contracts at the reporting date, thereby taking into account and approximating the current unrealized and realized gains or losses of open contracts. The notional amounts of forward exchange contracts are not a measure of VMS's exposure.

Interest Rate Risk

VMS's exposure to market risk for changes in interest rates relates primarily to its investment portfolio, notes payable, and long-term debt obligations. VMS does not use derivative financial instruments in its investment portfolio, and VMS's investment portfolio only includes highly liquid instruments with an original maturity to VMS of three months or less. VMS primarily enters into debt obligations to support general corporate purposes, including working capital requirements, capital expenditures, and acquisitions.

VMS is subject to fluctuating interest rates that may impact, adversely or otherwise, its results of operations or cash flows for its variable rate notes payable and cash and cash equivalents. Fluctuations in interest rates may also impact, adversely or otherwise, the estimated fair value of VMS's fixed rate long-term debt obligations. VMS has no cash flow exposure due to rate changes for long-term debt obligations.

The table below presents principal amounts and related weighted average interest rates by year of maturity for VMS's investment portfolio and debt

obligations.

| | Fiscal year | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2000 | 2001 | 2002 | 2003 | 2004 | Thereafter | Total |
| | (Dollars in millions) | | | | | | |
| Assets | | | | | | | |
| Cash and cash equivalents | $25.1 | -- | -- | -- | -- | -- | $25.1 |
| Average interest rate | 2.5% | -- | -- | -- | -- | -- | 2.5% |
| Liabilities | | | | | | | |
| Notes payable | $35.6 | -- | -- | -- | -- | -- | $35.6 |
| Average interest rate | 6.1% | -- | -- | -- | -- | -- | 6.1% |
| Long-term debt (including current portion) | -- | -- | -- | -- | -- | $58.5 | $58.5 |
| Average interest rate | -- | -- | -- | -- | -- | 6.82% | 6.82% |



The estimated fair value of the Company's cash and cash equivalents approximates the principal amounts reflected above based on the short maturities of these financial instruments. The estimated fair value of the Company's debt obligations approximates the principal amounts reflected above based on rates currently available to the Company for debt with similar terms and remaining maturities.

Although payments under certain of the Company's operating leases for its facilities are tied to market indices, the Company is not exposed to material interest rate risk associated with its operating leases.

Item 8. Financial Statements and Supplementary Data

The response to this item is submitted as a separate section of this report. See Item 14.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.



PART III

Item 10. Directors and Executive Officers of the Registrant

The information required by this item with respect to the Company's executive officers is set forth in Item 1 of this report. The balance of the information required by this item is incorporated by reference from the Company's Definitive Proxy Statement for the 2000 Annual Meeting of Stockholders under the captions "Election of Directors" and "Stock Ownership--Section 16(a) Beneficial Ownership Reporting Compliance."

Item 11. Executive Compensation

The information required by this item is incorporated by reference from the Company's Definitive Proxy Statement for the 2000 Annual Meeting of Stockholders under the caption "Compensation of Directors and the Named Executive Officers."

Item 12. Security Ownership of Certain Beneficial Owners and Management

The information required by this item is incorporated by reference from the Company's Definitive Proxy Statement for the 2000 Annual Meeting of Stockholders under the caption "Stock Ownership--Beneficial Ownership of Certain Stockholders and Executive Officers."

Item 13. Certain Relationships and Related Transactions

The information required by this item is incorporated by reference from the Company's Definitive Proxy Statement for the 2000 Annual Meeting of Stockholders under the captions "Compensation of Directors and the Named Executive Officers--Certain Transactions" and "Change in Control Agreements."



PART IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) The following documents are filed as part of this report:

(1) Consolidated Financial Statements: (see index on page F-1 of this report)

--Report of Independent Accountants

--Consolidated Statements of Earnings for fiscal years 1999, 1998, and 1997

--Consolidated Balance Sheets at fiscal year-end 1999 and 1998

--Consolidated Statements of Stockholders' Equity for fiscal years 1999, 1998, and 1997

--Consolidated Statements of Cash Flows for fiscal years 1999, 1998, and 1997

--Notes to the Consolidated Financial Statements

(2) Consolidated Financial Statement Schedule: (see index on page F-1 of this report)

The following financial statement schedule of the Registrant and its subsidiaries for fiscal years 1999, 1998, and 1997, and the related Report of Independent Accountants are filed as a part of this report and should be read in conjunction with the Consolidated Financial Statements of the Registrant and its subsidiaries.

| Schedule | |
|---|---|
| -- | Report of Independent Accountants on Financial Statement Schedule |
| II | Valuation and Qualifying Accounts |

All other schedules are omitted because of the absence of conditions under which they are required or because the required information is given in the financial statements or the notes thereto.

(3) Exhibits:

See attached Exhibit Index.

(b) The Company filed no reports on Form 8-K during the fourth quarter of fiscal 1999.



SIGNATURES

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

Date: December 21, 1999

Varian Medical Systems, Inc.

By: /s/ Elisha W. Finney
Elisha W. Finney
Vice President, Finance
Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated.

| Signature | Capacity | Date |
|---|---|---|
| /s/ Richard M. Levy<br>Richard M. Levy | President and Chief Executive Officer (Principal Executive Officer) | December 21, 1999 |
| /s/ Elsiha W. Finney<br>Elisha W. Finney | Vice President, Finance and Chief Financial Officer (Principal Financial Officer) | December 21, 1999 |
| /s/ Duane A. Walstrom | Controller (Principal | December 21, 1999 |

| | | |
|---|---|---|
| Duane A. Walstrom | Accounting Officer) | |
| /s/ John Seely Brown<br>John Seely Brown | Director | December 21, 1999 |



| Signature | Capacity | Date |
|---|---|---|
| /s/ Samuel Hellman<br>Samuel Hellman | Director | December 21, 1999 |
| /s/ Terry R. Lautenbach<br>Terry R. Lautenbach | Director | December 21, 1999 |
| /s/ David W. Martin, Jr.<br>David W. Martin, Jr. | Director | December 21, 1999 |
| /s/ Burton Richter<br>Burton Richter | Director | December 21, 1999 |
| /s/ Richard W. Vieser<br>Richard W. Vieser | Director | December 21, 1999 |



VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARY COMPANIES

FORM 10-K

INDEX OF FINANCIAL STATEMENTS AND SCHEDULES

The following financial statements of the registrant and its subsidiaries are required to be included in Item 8:



The following financial statement schedule of the Registrant and its subsidiaries for fiscal years 1999, 1998, and 1997, and the related Report of Independent Accountants are filed as a part of this report as required to be included in Item 14(a) and should be read in conjunction with the Consolidated Financial Statements of the Registrant and its subsidiaries:



All other schedules are omitted because of the absence of conditions under which they are required or because the required information is given in the financial statements or the notes thereto.

VARIAN MEDICAL SYSTEMS, INC.

REPORT OF INDEPENDENT ACCOUNTANTS

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of earnings, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Varian Medical Systems, Inc. and its subsidiaries at October 1, 1999 and October 2, 1998, and the results of their operations and their cash flows for each of the three years in the period ended October 1, 1999 in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

San Jose, California
November 4, 1999



VARIAN MEDICAL SYSTEMS AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF EARNINGS

| | Fiscal Years | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| | (Amounts in thousands, except per share amounts) | | |
| Sales | $590,440 | $541,461 | $474,300 |
| Operating Costs and Expenses | | | |
| Cost of sales | 380,435 | 346,298 | 310,682 |
| Research and development | 39,895 | 39,255 | 31,211 |
| Selling, general and administrative | 116,131 | 117,528 | 100,076 |
| Reorganization | 29,668 | -- | -- |
| Total Operating Costs and Expenses | 566,129 | 503,081 | 441,969 |
| Operating Earnings | 24,311 | 38,380 | 32,331 |
| Interest expense | (9,980) | (8,835) | (7,783) |
| Interest income | 3,908 | 6,418 | 4,604 |
| Earnings from Continuing Operations Before Taxes | 18,239 | 35,963 | 29,152 |
| Taxes on earnings | 10,021 | 9,819 | 9,183 |
| Earnings from Continuing Operations | 8,218 | 26,144 | 19,969 |
| Earnings (Loss) from Discontinued Operations--Net of Taxes | (32,456) | 47,696 | 95,591 |
| Net Earnings (Loss) | $(24,238) | $ 73,840 | $115,560 |
| Average Shares Outstanding--Basic | 30,219 | 29,910 | 30,451 |
| Average Shares Outstanding--Diluted | 30,527 | 30,419 | 31,446 |
| Net Earnings (Loss) Per Share--Basic | | | |
| Continuing Operations | $ 0.27 | $ 0.87 | $ 0.66 |
| Discontinued Operations | (1.07) | 1.60 | 3.13 |
| Net Earnings (Loss) Per Share--Basic | $ (0.80) | $ 2.47 | $ 3.79 |
| Net Earnings (Loss) Per Share--Diluted | | | |

| | | | |
|---|---|---|---|
| Continuing Operations | $ 0.27 | $ 0.86 | $ 0.64 |
| Discontinued Operations | (1.06) | 1.57 | 3.03 |
| Net Earnings (Loss) Per Share--Diluted | $ (0.79) | $ 2.43 | $ 3.67 |

See accompanying notes to the consolidated financial statements



VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEETS

| | Fiscal Year-End | |
|---|---|---|
| | October 1, 1999 | October 2, 1998 |
| | (Dollars in thousands, except par values) | |
| **Assets** | | |
| Current Assets | | |
| Cash and cash equivalents | $ 25,126 | $ 149,667 |
| Accounts receivable | 233,785 | 392,596 |
| Inventories | 78,324 | 204,464 |
| Other current assets | 45,011 | 93,054 |
| Total Current Assets | 382,246 | 839,781 |
| Property, Plant, and Equipment | 200,386 | 509,089 |
| Accumulated depreciation and amortization | (120,138) | (294,867) |
| Net Property, Plant, and Equipment | 80,248 | 214,222 |
| Other Assets | 76,689 | 164,292 |
| Total Assets | $539,183 | $1,218,295 |
| **Liabilities and Stockholders' Equity** | | |
| Current Liabilities | | |
| Notes payable | $ 35,587 | $ 46,842 |
| Accounts payable--trade | 40,141 | 76,166 |
| Accrued expenses | 121,165 | 282,647 |
| Product warranty | 18,152 | 44,153 |
| Advance payments from customers | 54,757 | 55,081 |
| Total Current Liabilities | 269,802 | 504,889 |
| Long-Term Accrued Expenses | 25,890 | 44,771 |
| Long-Term Debt | 58,500 | 111,090 |
| Total Liabilities | 354,192 | 660,750 |
| Commitments and Contingencies | | |
| Stockholders' Equity | | |
| Preferred stock | | |
| Authorized 1,000,000 shares, par value $1, issued none | -- | -- |
| Common stock | | |
| Authorized 99,000,000 shares, par value $1, issued and outstanding 30,563,000 shares at October 1, 1999 and 29,743,000 shares at October 2, 1998 | 30,563 | 29,743 |
| Capital in excess of par value | 20,185 | -- |
| Retained earnings | 134,243 | 527,802 |
| Total Stockholders' Equity | 184,991 | 557,545 |
| Total Liabilities and Stockholders' Equity | $539,183 | $1,218,295 |

</TABLE>

See accompanying notes to the consolidated financial statements



VARIAN MEDICAL SYSTEMS AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

| | Common Stock | | Capital in Excess of | Retained | Treasury Stock | |
|---|---|---|---|---|---|---|
| | Shares | Amount | Par Value | Earnings | at Cost | Total |
| | (In thousands, except per share amounts) | | | | | |
| Balances, Fiscal Year-End, 1996 | 30,646 | $30,646 | $ -- | $437,263 | $ -- | $467,909 |
| Net earnings for the year | -- | -- | -- | 115,560 | -- | 115,560 |
| Issuance of stock under omnibus stock, stock option, and employee stock purchase plans (including tax benefit of $8,299) | 1,221 | 1,221 | 45,261 | -- | -- | 46,482 |
| Purchase of common stock | -- | -- | -- | -- | (94,730) | (94,730) |
| Retirement of treasury stock | (1,759) | (1,759) | (45,261) | (47,710) | 94,730 | -- |
| Dividends declared ($0.35 per share) | -- | -- | -- | (10,644) | -- | (10,644) |
| Balances, Fiscal Year-End, 1997 | 30,108 | 30,108 | -- | 494,469 | -- | 524,577 |
| Net earnings for the year | -- | -- | -- | 73,840 | -- | 73,840 |
| Issuance of stock under omnibus stock, stock option, and employee stock purchase plans (including tax benefit of $5,321) | 646 | 646 | 24,407 | -- | -- | 25,053 |
| Purchase of common stock | -- | -- | -- | -- | (54,276) | (54,276) |
| Retirement of treasury stock | (1,011) | (1,011) | (24,407) | (28,858) | 54,276 | -- |
| Dividends declared ($0.39 per share) | -- | -- | -- | (11,649) | -- | (11,649) |
| Balances, Fiscal Year-End, 1998 | 29,743 | 29,743 | -- | 527,802 | -- | 557,545 |
| Net loss for the year | -- | -- | -- | (24,238) | -- | (24,238) |
| Issuance of stock under omnibus stock, stock option, and employee stock purchase plans (including tax benefit of $5,338) | 820 | 820 | 20,185 | -- | -- | 21,005 |
| Dividends declared ($0.10 per share) | -- | -- | -- | (2,991) | -- | (2,991) |
| Spin Distribution | -- | -- | -- | (366,330) | -- | (366,330) |
| Balances, Fiscal Year-End, 1999 | 30,563 | $30,563 | $20,185 | $134,243 | $ -- | $184,991 |

See accompanying notes to the consolidated financial statements.



VARIAN MEDICAL SYSTEMS AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Fiscal Years | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| | (Dollars in thousands) | | |
| Operating Activities | | | |
| Net Cash (Used)/Provided by Operating Activities | $ (33,557) | $ 127,753 | $ 44,939 |
| Investing Activities | | | |
| Proceeds from sale of property, plant, and equipment | 54,260 | 2,321 | 2,220 |
| Proceeds from sale of Thin Film Systems Business | -- | -- | 145,500 |
| Purchase of property, plant, and equipment | (39,402) | (46,954) | (55,087) |
| Purchase of businesses, net of cash acquired | (5,849) | (105,470) | (34,272) |
| Other, net | 3,851 | 7,035 | (8,685) |

| | | | |
|---|---|---|---|
| Net Cash Provided/(Used) by Investing Activities | 12,860 | (143,068) | 49,676 |
| Financing Activities | | | |
| Net borrowings on short-term obligations | 11,253 | 27,624 | 2,305 |
| Proceeds from long-term borrowings | -- | 38,000 | 25,000 |
| Principal payments on long-term debt | (12,138) | (96) | (71) |
| Proceeds from common stock issued to employees | 15,667 | 19,732 | 38,183 |
| Purchase of common stock | -- | (54,276) | (94,730) |
| Dividends paid | (2,991) | (14,348) | (10,399) |
| Cash distributed in spin-off of businesses | (119,273) | -- | -- |
| Other, net | 2,792 | 2,692 | (245) |
| Net Cash (Used)/Provided by Financing Activities | (104,690) | 19,328 | (39,957) |
| Effects of Exchange Rate Changes on Cash | 846 | 3,356 | 4,965 |
| Net (Decrease) Increase in Cash and Cash Equivalents | (124,541) | 7,369 | 59,623 |
| Cash and Cash Equivalents at Beginning of Fiscal Year | 149,667 | 142,298 | 82,675 |
| Cash and Cash Equivalents at End of Fiscal Year | $ 25,126 | $ 149,667 | $142,298 |
| Detail of Net Cash Provided by Operating Activities | | | |
| Net (Loss)/Earnings | $ (24,238) | $ 73,840 | $115,560 |
| Adjustments to reconcile net (loss)/earnings to net cash provided by operating activities: | | | |
| Depreciation | 30,879 | 42,663 | 45,649 |
| (Gain)/loss from sale of assets | (30,565) | 62 | 974 |
| Amortization of intangibles | 6,519 | 4,993 | 3,614 |
| Gain on sale of Thin Film Systems business | -- | -- | (51,039) |
| Deferred taxes | (20,850) | (5,166) | (9,703) |
| Changes in assets and liabilities: | | | |
| Accounts receivable | (29,896) | 33,790 | (61,312) |
| Inventories | 3,295 | (18,098) | (5,586) |
| Other current assets | (14,098) | (2,458) | 3,770 |
| Accounts payable--trade | 6,558 | (16,728) | 10,479 |
| Accrued expenses | 28,435 | 1,650 | (24,859) |
| Product warranty | (2,961) | 2,061 | (2,666) |
| Advance payments from customers | 13,319 | 186 | 3,633 |
| Long-term accrued expenses | (3,056) | 9,019 | 11,251 |
| Other | 3,102 | 1,939 | 5,174 |
| Net Cash (Used)/Provided by Operating Activities | $ (33,557) | $ 127,753 | $ 44,939 |

See accompanying notes to the consolidated financial statements.



VARIAN MEDICAL SYSTEMS, INC., AND SUBSIDIARY COMPANIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## Summary of Significant Accounting Policies

### Fiscal Year

The Company's fiscal years reported are the 52- or 53- week periods which ended on the Friday nearest September 30. Fiscal year 1999 comprises the 52-week period ended on October 1, 1999. Fiscal year 1998 comprises the 53-week period ended on October 2, 1998 and fiscal year 1997 comprises the 52-week period ended on September 26, 1997.

### Principles of Consolidation

The consolidated financial statements include those of the Company and its subsidiaries. Significant intercompany balances, transactions, and stock holdings have been eliminated in consolidation. Investments in affiliated companies over whose operations the Company has significant influence but not control are accounted for under the equity method.

### Distribution

On April 2, 1999, Varian Associates, Inc. reorganized into three separate publicly traded companies by spinning off, through a tax-free distribution, two of its businesses to stockholders (the "Distribution"). The Distribution resulted in the following three companies: 1) the Company (renamed from Varian Associates, Inc. to Varian Medical Systems, Inc. following the Distribution); 2) Varian, Inc. ("VI"); and 3) Varian Semiconductor Equipment Associates, Inc.

("VSEA"). On February 19, 1999, following receipt of a private letter ruling from the Internal Revenue Service to the effect that the Distribution would be tax-free to the Company and its stockholders and following the approval of the plan for the Distribution by the Company's stockholders, the Company's Board of Directors declared a stock dividend to stockholders of record on March 24, 1999, consisting of one share of VI common stock and one share of VSEA common stock for each share of Company common stock held on April 2, 1999. The Distribution resulted in a non-cash dividend to stockholders that has reduced the Company's stockholders' equity by $366.3 million.

These transactions were accomplished under the terms of an Amended and Restated Distribution Agreement dated as of January 14, 1999 by and among the Company, VI and VSEA. For purposes of governing certain of the ongoing relationships between and among the Company, VI and VSEA after the Distribution, the Company, VI and VSEA also entered into various agreements including an Employee Benefits Allocation Agreement, Intellectual Property Agreement, Tax Sharing Agreement and Transition Services Agreement. These agreements set forth the principles to be applied in allocating certain related costs and specified portions of contingent liabilities to be shared, which, by their nature, could not be reasonably estimated at the time. Certain adjustments may be required under the Distribution Agreement or the Distribution Related Agreements. The Company may be required to make cash payments to VI or VSEA, or may be entitled to receive cash payments from VI or VSEA. The amount of such adjustments, if any, are not expected to be material.

Pursuant to Accounting Principles Board (APB) Opinion No. 30, "Reporting the Results of Operations--Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," the Company has reclassified its consolidated statements of earnings for all periods presented to reflect the dispositions of VI and VSEA. The net operating results of VI and VSEA have been reported, net of applicable income taxes, as "Earnings (Loss) from Discontinued Operations."

The loss on the disposition was $5.5 million (net of income taxes of $3.0 million) and related to employee relocation, severance, retention, and other payroll costs directly associated with the disposal of VI and VSEA.





Summarized information for discontinued operations, excluding the above loss on disposal, is as follows (dollars in millions):

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Revenue | $375.7 | $880.7 | $951.5 |
| Earnings (Loss) before Taxes | $(39.5) | $ 76.8 | $148.6 |
| Net Earnings (Loss) | $(27.0) | $ 47.7 | $ 95.6 |

Use of Estimates

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

Foreign Currency Translation

For non-U.S. operations, the U.S. dollar is the functional currency. Monetary assets and liabilities of foreign subsidiaries are translated into U.S. dollars at current exchange rates. Nonmonetary assets such as inventories and property, plant, and equipment are translated at historical rates. Income and expense items are translated at effective rates of exchange prevailing during each year, except that inventories and depreciation charged to operations are translated at historical rates. The aggregate exchange loss included in selling, general and administrative expenses for 1999, 1998, and 1997 was $4.4 million, $2.2 million, and $0.3 million, respectively.

Revenue Recognition

Sales and related cost of sales for hardware are generally recognized upon shipment of products which in some cases precedes customer acceptance, as the performance of installation obligations is essentially perfunctory and there is a demonstrated history of customer acceptance following shipment. Sales and related cost of sales for software products are generally recognized at the

time of customer acceptance which normally is within 30 days after installation. The Company's products are generally subject to installation and warranty, and the Company provides for the estimated future costs of installation, repair, replacement, or customer accommodation in cost of sales when sales are recognized. Service revenue is recognized ratably over the period of the related contract.

Statements of Cash Flows

The Company considers currency on hand, demand deposits, and all highly liquid investments with an original maturity of three months or less to be cash and cash equivalents. The carrying amounts of cash and cash equivalents approximate estimated fair value because of the short maturities of those financial instruments.

Reclassifications

Certain financial statement items have been reclassified to conform to the current years's format. These reclassifications had no impact on previously reported net earnings.





Accounts Receivable

Accounts receivable are stated net of allowances for doubtful accounts of $1.1 million at the end of fiscal year 1999 and $2.6 million at the end of fiscal year 1998.

Financial instruments that potentially expose the Company to concentrations of credit risk consist principally of trade accounts receivable. Concentrations of credit risk with respect to trade accounts receivable are limited due to the large number of customers comprising the Company's customer base and their dispersion across many geographies. The Company performs ongoing credit evaluations of its customers and generally does not require collateral from its customers.

Inventories

Inventories are valued at the lower of cost or market (realizable value) using last-in, first-out (LIFO) cost for the U.S. inventories of the Company (except X-ray Products). All other inventories are valued principally at average cost. If the first-in, first-out (FIFO) method had been used for those operations valuing inventories on a LIFO basis, inventories would have been higher than reported by $14.2 million in fiscal 1999, $44.7 million in fiscal 1998, and $48.4 million in fiscal 1997. The main components of inventories are as follows:

| | 1999 | 1998 |
|---|---|---|
| | (Dollars in millions) | |
| Raw materials and parts | $61.9 | $132.4 |
| Work in process | 7.8 | 43.2 |
| Finished goods | 8.6 | 28.9 |
| Total Inventories | $78.3 | $204.5 |

The Company's inventories include high technology parts and components that may be specialized in nature or subject to rapid technological obsolescence. While the Company has programs to minimize the required inventories on hand and considers technological obsolescence in estimating the required allowance to reduce recorded amounts to market values, such estimates could change in the future.

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Major improvements are capitalized, while maintenance and repairs are expensed currently. Plant and equipment are depreciated over their estimated useful lives, ranging from three to forty years, using the straight-line method for financial reporting purposes and accelerated methods for tax purposes. Leasehold improvements are amortized using the straight-line method over their estimated useful lives, or the remaining term of the lease, whichever is less. When assets are retired or otherwise disposed of, the assets and related accumulated depreciation are removed from the accounts. Gains or losses resulting from retirements or disposals are included in earnings.

The main components of property, plant, and equipment are as follows:

| | 1999 | 1998 |
|---|---|---|
| | (Dollars in millions) | |
| Land and land improvements | $ 5.4 | $ 14.2 |
| Buildings | 58.7 | 179.8 |
| Machinery and equipment | 124.4 | 306.4 |
| Construction in progress | 11.9 | 8.7 |
| Total Property, Plant, and Equipment | $200.4 | $509.1 |





Goodwill and Other Long-Lived Assets

Goodwill, which is the excess of the cost of acquired businesses over the sum of the amounts assigned to identifiable assets acquired less liabilities assumed, is amortized on a straight-line basis over periods ranging from 7 to 40 years. Included in other assets at October 1, 1999 and October 2, 1998 is goodwill of $56.1 million and $132.5 million, respectively (net of accumulated amortization of $7.1 million and $9.8 million, respectively).

Whenever events or changes in circumstances indicate that the carrying amounts of long-lived assets and goodwill related to those assets may not be recoverable, the Company estimates the future cash flows, undiscounted and without interest charges, expected to result from the use of those assets and their eventual disposition. If the sum of the future cash flows is less than the carrying amount of those assets, the Company recognizes an impairment loss based on the excess of the carrying amount over the fair value of the assets.

Environmental Liabilities

Liabilities are recorded when environmental assessments and/or remedial efforts are probable, and the costs can be reasonably estimated. Generally, the timing of these accruals coincides with completion of a feasibility study or the Company's commitment to a formal plan of action.

During fiscal 1997, the Company adopted the AICPA's SOP 96-1, "Environmental Remediation Liabilities." As a result of the adoption of SOP 96-1, the Company increased the reserve for environmental liabilities by $8.8 million.

Taxes on Earnings

The Company's provision for income taxes comprises its estimated tax liability currently payable and the change in its deferred income taxes. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts.

Research and Development

Company-sponsored research and development costs related to both present and future products are expensed currently. Costs related to research and development contracts are included in inventory and charged to cost of sales upon recognition of related revenue. Included in sales for fiscal 1999, 1998, and 1997, were customer funded research and development projects of $1.2 million, $1.6 million, and $2.7 million, respectively.





Computation of Earnings Per Share (Shares in thousands)

Earnings per share (EPS) is computed under two methods, basic and diluted. Basic net earnings (loss) per share is computed by dividing earnings (loss) available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per share is computed by dividing earnings (loss) available to common stockholders by the sum of the weighted average number of common shares outstanding and potential common shares (when dilutive). A reconciliation of the numerator and denominator used in the earnings per share calculations is presented as

follows:

| | Fiscal Year 1999 | Fiscal Year 1998 | Fiscal Year 1997 |
|---|---|---|---|
| Numerator--Basic and Diluted: | | | |
| Earnings from Continuing Operations..... | $ 8,218 | $26,144 | $ 19,969 |
| Earnings (Loss) from Discontinued Operations..... | (32,456) | 47,696 | 95,591 |
| Net Earnings (Loss)..... | $(24,238) | $73,840 | $115,560 |
| Denominator--Basic: | | | |
| Average shares outstanding..... | 30,219 | 29,910 | 30,451 |
| Net Earnings (Loss) Per Share--Basic: | | | |
| Continuing Operations..... | $ 0.27 | $ 0.87 | $ 0.66 |
| Discontinued Operations..... | (1.07) | 1.60 | 3.13 |
| Net Earnings (Loss) Per Share--Basic.... | $ (0.80) | $ 2.47 | $ 3.79 |
| Denominator--Diluted: | | | |
| Average shares outstanding..... | 30,219 | 29,910 | 30,451 |
| Dilutive stock options..... | 308 | 509 | 995 |
| | 30,527 | 30,419 | 31,446 |
| Net Earnings (Loss) Per Share--Diluted: | | | |
| Continuing Operations..... | $ 0.27 | $ 0.86 | $ 0.64 |
| Discontinued Operations..... | (1.06) | 1.57 | 3.03 |
| Net Earnings (Loss) Per Share--Diluted.. | $ (0.79) | $ 2.43 | $ 3.67 |

Options to purchase 2,446,756 shares, 1,741,459 shares, and 47,937 shares at average exercise prices of $23.69, $48.59, and $59.84, respectively, were outstanding during fiscal 1999, 1998, and 1997, respectively, but were not included in the computation of diluted EPS because the options' exercise price was greater than the average market price of the shares.

Recent Accounting Pronouncements

Accounting for Derivative Instruments and Hedging Activities

In June 1998, the Financial Accounting and Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS 133 requires derivatives to be measured at fair value and to be recorded as assets or liabilities on the balance sheet. The accounting for gains or losses resulting from changes in the fair values of those derivatives would be dependent upon the use of the derivative and whether it qualifies for hedge accounting. SFAS 133 is effective for the Company's fiscal year 2001. The Company has not yet determined the impact of its implementation on the Company's consolidated financial statements.





Accrued Expenses

| | 1999 | 1998 |
|---|---|---|
| | (Dollars in millions) | |
| Taxes, including taxes on earnings..... | $ 17.6 | $ 46.2 |
| Payroll and employee benefits..... | 20.4 | 84.9 |
| Estimated loss contingencies..... | 14.6 | 54.6 |
| Deferred income..... | 10.2 | 27.3 |
| Reorganization costs..... | 8.3 | -- |
| Other..... | 50.1 | 69.6 |
| Total Accrued Expenses..... | $121.2 | $282.6 |

Notes Payable

Short-term notes payable and the current portion of long-term debt amounted to $35.6 million and $46.8 million at the end of fiscal years 1999 and 1998, respectively. The weighted average interest rates on short-term borrowings were 6.1% and 3.6% at the end of fiscal years 1999 and 1998, respectively. Total debt is subject to limitations included in long-term debt agreements. The Company had $78.2 million available in unused, uncommitted lines of credit at October 1, 1999.

Long-Term Accrued Expenses

Long-term accrued expenses are comprised primarily of accruals for environmental costs not expected to be expended within the next year. The current portion is recorded within accrued expenses.

Long-Term Debt

| | 1999 | 1998 |
|---|---|---|
| | (Dollars in millions) | |
| Unsecured term loan, 6.70% due in installments of $6.25 payable fiscal years 2008, 2010, 2012, and 2014 | $ 25.0 | $ 50.0 |
| Unsecured term loan, 6.76% due in semiannual installments of $5.25 payable fiscal years 2005, 2007, 2009, and 2011 | 21.0 | 48.0 |
| Unsecured term loan, 7.15% due in installments of $2.5 payable fiscal years 2006-2010 | 12.5 | 25.0 |
| Other debt | -- | 0.2 |
| Long-term borrowings | 58.5 | 123.2 |
| Less current portion | -- | 12.1 |
| Long-term Debt | $ 58.5 | $ 111.1 |

The unsecured term loans contain covenants that limit future borrowings and require the Company to maintain certain levels of working capital and operating results. For fiscal year 1999, the Company was in compliance with all restrictive covenants of the loan agreements. The financing agreements restrict the payment of dividends.

Interest paid (in millions) on short and long-term debt was $7.6, $8.2, and $7.6, in fiscal years 1999, 1998, and 1997, respectively.

Based on rates currently available to the Company for debt with similar terms and remaining maturities, the carrying amounts of long-term debt and notes payable approximate estimated fair value.





Forward Exchange Contracts

The Company enters into forward exchange contracts to mitigate the effects of operational (sales orders and purchase commitments) and balance sheet exposures to fluctuations in foreign currency exchange rates. When the Company's foreign exchange contracts hedge operational exposure, the effects of movements in currency exchange rates on these instruments are recognized in income when the related revenues and expenses are recognized. When foreign exchange contracts hedge balance sheet exposure, such effects are recognized in income when the exchange rate changes. Because the impact of movements in currency exchange rates on foreign exchange contracts generally offsets the related impact on the underlying items being hedged, these instruments do not subject the Company to risk that would otherwise result from changes in currency exchange rates. Gains and losses on hedges of existing assets or liabilities are included in the carrying amounts of those assets or liabilities and are ultimately recognized in income as part of those carrying amounts. Gains and losses related to qualifying hedges of firm commitments also are deferred and are recognized in income or as adjustments of carrying amounts when the hedged transaction occurs. Any deferred gains or losses are included in accrued expenses in the balance sheet. If a hedging instrument is sold or terminated prior to maturity, gains and losses continue to be deferred until the hedged item is recognized in income. If a hedging instrument ceases to qualify as a hedge, any subsequent gains and losses are recognized currently in income. The Company's forward exchange contracts generally range from one to three months in original maturity, and no forward exchange contract has an original maturity greater than one year. Forward exchange contracts outstanding, their unrealized gains or losses and their fair values as of fiscal year-end 1999 are summarized as follows:

| | Fiscal Year-End 1999 | | | |
|---|---|---|---|---|
| | Notional Value Sold | Notional Value Purchased | Unrealized Gain/(Loss) | Fair Value |
| | (Dollars in millions) | | | |
| Australian dollar | $ 5.3 | $ -- | $(0.1) | $(0.1) |
| Brazilian real | -- | 0.6 | -- | -- |
| British pound | 5.3 | 1.5 | -- | -- |
| Canadian dollar | 6.4 | -- | (0.1) | (0.1) |
| Danish krona | -- | 4.8 | 0.1 | 0.1 |
| Euro dollar | 66.1 | -- | (0.5) | (1.1) |
| Japanese yen | 5.4 | -- | (0.2) | (0.2) |
| Norwegian kroner | 2.5 | -- | (0.1) | (0.1) |
| Swedish krona | 1.8 | -- | (0.1) | (0.1) |
| Swiss franc | -- | 7.6 | 0.2 | 0.2 |
| Thailand baht | 1.7 | -- | 0.2 | 0.1 |
| Totals | $94.5 | $14.5 | $(0.6) | $(1.3) |

The fair value of forward exchange contracts generally reflects the estimated amounts that the Company would receive or pay to terminate the contracts at the reporting date, thereby taking into account and approximating the current unrealized and realized gains or losses of open contracts. The notional amounts of forward exchange contracts are not a measure of the Company's exposure.

Omnibus Stock and Employee Stock Purchase Plans (Shares in thousands)

Prior to fiscal 1991, the Company had in place the 1982 Non-Qualified Stock option Plan (the 1982 Plan). During fiscal 1991, the Company adopted the Omnibus Stock Plan (the Plan), which was amended and restated as of the Distribution, under which shares of common stock can be issued to officers, directors, key employees and consultants. The maximum number of shares of common stock available for awards under the Plan is 5,000





exclusive of substitute options issued in connection with the Distribution. The exercise price for incentive and nonqualified stock options granted under the Plan may not be less than 100% of the fair market value at the date of the grant. For employees holding more than 10% of the voting rights of all classes of stock, the exercise price of incentive stock options may not be less than 110% of the fair market value at the date of grant. Options granted will be exercisable at such times and be subject to such restrictions and conditions as determined by the Organization and Compensation Committee of the Company's Board of Directors, but no option shall be exercisable later than five years from the date of grant for incentive stock options for which the grantee owns greater than 10% of the voting power of all classes of stock and no longer than ten years from the date of grant for all other options. Options granted are generally exercisable in cumulative installments of one-third each year, commencing one year following date of grant, and expire if not exercised within seven or ten years from date of grant. Restricted stock grants may be awarded at prices ranging from 0% to 50% of the fair market value of the stock and may be subject to restrictions on transferability and continued employment as determined by the Organization and Compensation Committee.

Option activity under the 1982 Plan and the Plan is presented below:

| | Options | Weighted Average Exercise Price |
|---|---|---|
| Options outstanding, September 27, 1996 | 3,877 | $31.08 |
| Granted | 1,089 | 48.89 |
| Terminated or expired | (224) | 45.75 |
| Exercised | (1,000) | 28.58 |
| Options outstanding, September 26, 1997 | 3,742 | 36.43 |
| Granted | 1,041 | 56.68 |
| Terminated or expired | (116) | 49.21 |
| Exercised | (416) | 23.21 |
| Options outstanding, October 2, 1998 | 4,251 | 42.33 |
| Granted | 61 | 37.28 |

| | | |
|---|---|---|
| Terminated or expired | (70) | 47.47 |
| Exercised | (531) | 15.78 |
| Options outstanding, April 1, 1999 | 3,711 | 43.40 |
| Attributable to discontinued operations | (2,133) | 46.44 |
| Options Outstanding, April 1, 1999, prior to conversion | 1,578 | 45.36 |
| Options converted at April 2, 1999 | 3,445 | $20.78 |
| Granted | 2,676 | 18.32 |
| Terminated or expired | (32) | 22.71 |
| Exercised | (140) | 23.01 |
| Options Outstanding October 1, 1999 | 5,949 | $19.92 |

During fiscal years 1999, 1998 and 1997, options for 2,939, 2,406 and 1,935 shares of common stock were exercisable and 621, 580 and 667 shares were available for future grants under the plans, respectively.

In April 1999, in conjunction with the Distribution, those individuals who became employees of VI or VSEA were granted substitute awards in the stock of their new employer, and any stock options held by them in respect of the Company are reflected as surrendered attributable to discontinued operations in the above table. Options held by certain individuals whose employment was terminated in connection with the Distribution were granted substitute options in VMS, VI and VSEA equal in each case to one third of the unexercised options held





as of the Distribution. The number of shares subject to options and the option exercise price were adjusted immediately following the Distribution to preserve, as closely as possible, the economic value of the options that existed prior to the Distribution. For the remaining holders of unexercised options, the number of shares subject to options and the option exercise price was adjusted immediately following the Distribution to preserve, as closely as possible, the economic value of the options that existed prior to the Distribution.

During fiscal years 1999, 1998 and 1997, 22, 52 and 55 shares, respectively, were awarded under restricted stock grants at no cost to the employees. The restricted stock grants vest generally over a three-year period, however, restricted stock was vested for all employees immediately prior to the Distribution. Compensation expense from restricted stock was $2.7 million, $3.0 million, and $2.7 million, in fiscal years 1999, 1998, and 1997, respectively.

The Employee Stock Purchase Plan (the ESPP) covers substantially all employees in the United States and Canada. The participants' purchase price is the lower of 85% of the closing market price on the first trading day of the fiscal quarter or the first trading day of the next fiscal quarter. The discount is treated as equivalent to the cost of issuing stock for financial reporting purposes. During fiscal 1999, 1998 and 1997, 130 shares, 176 shares, and 163 shares were issued under the ESPP for $3.7 million, $7.2 million and $6.9 million, respectively. At fiscal year-end 1999, the Company had a balance of 2,545 shares reserved for the ESPP. The ESPP was suspended effective January 4, 1999 and reinstated October 4, 1999.

The following tables summarize information concerning outstanding and exercisable options under the 1982 Plan and the Plan at the end of fiscal 1999:

| | Options Outstanding | | |
|---|---|---|---|
| Range of Exercise Prices | Number Outstanding | Weighted Average Remaining Contractual Life (in years) | Weighted Average Exercise Price |
| $ 6.94-$16.49 | 864 | 3.30 | $14.07 |
| 16.55-18.16 | 182 | 9.06 | 17.66 |
| 18.31 | 2,386 | 9.51 | 18.31 |
| 18.50-22.13 | 891 | 6.66 | 22.01 |
| 22.16-25.68 | 825 | 7.06 | 22.38 |
| 26.64-30.15 | 801 | 8.04 | 26.69 |
| Total | 5,949 | 7.63 | $19.92 |

| Range of Exercise Prices | Options Exercisable: Number Exercisable | Options Exercisable: Weighted Average Exercise Price |
|---|---|---|
| $ 6.94-$16.49 | 844 | $14.03 |
| 16.55-18.16 | 168 | 17.64 |
| 18.31 | 157 | 18.31 |
| 18.50-22.13 | 759 | 22.05 |
| 22.16-25.68 | 618 | 22.40 |
| 26.64-30.15 | 393 | 26.71 |
| Total | 2,939 | $19.99 |





The Company has adopted the pro forma disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." Accordingly, the Company applies APB Opinion 25 and related Interpretations in accounting for its stock compensation plans. If the Company had elected to recognize compensation cost based on the fair value of the options granted at grant date as prescribed by SFAS No. 123, net earnings and net earnings per share would have been reduced to the pro forma amounts shown below for fiscal years 1999, 1998 and 1997:

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| | (Dollars in thousands except per share amounts) | | |
| Earnings from Continuing Operations--as reported | $8,218 | $26,144 | $19,969 |
| Earnings from Continuing Operations--pro forma | $6,264 | $24,666 | $17,497 |
| Earnings from Continuing Operations per share--basic, as reported | $ 0.27 | $ 0.87 | $ 0.66 |
| Earnings from Continuing Operations per share--basic, pro forma | $ 0.21 | $ 0.82 | $ 0.57 |
| Earnings from Continuing Operations per share--diluted, as reported | $ 0.27 | $ 0.86 | $ 0.64 |
| Earnings from Continuing Operations per share--diluted, pro forma | $ 0.21 | $ 0.81 | $ 0.56 |

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

| | Employee Stock Options | | | Employee Stock Purchase Plan | | |
|---|---|---|---|---|---|---|
| | 1999 | 1998 | 1997 | 1999 | 1998 | 1997 |
| Expected dividend yield | -- | 0.8% | 0.8% | -- | 0.8% | 0.8% |
| Risk-free interest rate | 5.3% | 5.6% | 6.4% | 4.4% | 5.0% | 5.3% |
| Expected volatility | 29.0% | 24.0% | 21.0% | 29.0% | 24.0% | 21.0% |
| Expected life (in years): | | | | | | |
| Employees | 4 | 4 | 4 | .25 | .25 | .25 |
| Executive Officers | 7 | 7 | 7 | .25 | .25 | .25 |

The weighted average estimated fair values of employee stock options granted during fiscal 1999, 1998 and 1997 were $5.38, $18.06 and $14.65 per share, respectively. The weighted average estimated fair values of the ESPP awards issued during fiscal 1999, 1998 and 1997 were $ 9.90, $7.76 and $11.77 per share, respectively.

Retirement Plans

The Company has defined contribution retirement plans covering substantially all of its United States and Canadian employees. The Company's major obligation is to contribute an amount based on a percentage of each participant's base pay. For fiscal years 1998 and 1997 the Company contributed 5% of its consolidated earnings from continuing operations before taxes, as adjusted for discretionary items, as retirement plan profit sharing. For

fiscal year 1999 no retirement plan profit sharing contribution was made due to the Company's net loss resulting from the Distribution. Participants are entitled, upon termination or retirement, to their portion of the retirement fund assets, which are held by a third-party custodian. In addition, a number of the Company's foreign subsidiaries have defined benefit retirement plans for regular full-time employees. Total pension expense for all plans amounted to $5.5 million, $8.2 million and $8.1 million, for fiscal 1999, 1998 and 1997, respectively.





Taxes on Earnings

Taxes on earnings from continuing operations are as follows:

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| | (Dollars in millions) | | |
| Current | | | |
| U.S. federal | $ 7.1 | $ 2.9 | $ 4.0 |
| Non-U.S. | 15.3 | 7.9 | 2.9 |
| State and local | (.8) | 1.7 | 2.4 |
| Total current | 21.6 | 12.5 | 9.3 |
| Deferred | | | |
| U.S. federal | (11.0) | (3.1) | (0.5) |
| Non-U.S. | (.6) | .4 | 0.4 |
| Total deferred | (11.6) | (2.7) | (0.1) |
| Taxes on Earnings | $ 10.0 | $ 9.8 | $ 9.2 |

Significant items making up deferred tax assets and liabilities are as follows:

| | 1999 | 1998 |
|---|---|---|
| | (Dollars in millions) | |
| Assets: | | |
| Product warranty | $ 5.5 | $ 12.2 |
| Deferred compensation | 2.3 | 2.9 |
| Special provisions | 21.0 | 34.8 |
| Inventory adjustments | 6.5 | 25.5 |
| Deferred income | 1.7 | 5.7 |
| Accelerated depreciation | 1.7 | -- |
| Credit carryforward | 5.8 | -- |
| Other | 3.6 | 6.8 |
| | 48.1 | 87.9 |
| Liabilities: | | |
| Accelerated depreciation | -- | 9.7 |
| Net undistributed profits of foreign subsidiaries | 5.4 | -- |
| Other | 2.2 | 3.0 |
| | 7.6 | 12.7 |
| Net Deferred Tax Asset | $ 40.5 | $ 75.2 |

The classification of the net deferred tax asset on the consolidated balance sheet is as follows:

| | 1999 | 1998 |
|---|---|---|
| | (Dollars in millions) | |
| Net current deferred tax asset (included in other current assets) | $ 34.3 | $ 73.8 |

| | | |
|---|---|---|
| Net long-term deferred tax asset (included in other assets) | 6.2 | 1.4 |
| Net Deferred Tax Asset | $ 40.5 | $ 75.2 |





At October 1, 1999, the Company had federal tax carryforwards of approximately $5.8 million which expire in 2004, if not utilized.

The effective tax rate on continuing operations differs from the U.S. federal statutory tax rate as a result of the following:

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Federal statutory income tax rate | 35.0% | 35.0% | 35.0% |
| State and local taxes, net of federal tax benefit | (3.0) | 2.9 | 3.5 |
| Foreign taxes, net | 1.9 | (5.5) | (0.4) |
| Foreign sales corporation | (7.0) | (3.1) | (5.0) |
| Non-deductible transaction costs | 32.0 | 0.0 | 0.0 |
| Other | (4.0) | (2.0) | (1.6) |
| Effective Tax Rate | 54.9% | 27.3% | 31.5% |

Income taxes paid are as follows:

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| | (Dollars in millions) | | |
| Federal income taxes paid, net | $(12.7) | $ 8.0 | $41.9 |
| State income taxes paid, net | (.2) | 7.0 | 4.0 |
| Foreign income taxes paid, net | 23.1 | 12.8 | 18.3 |
| Total Paid | $ 10.2 | $27.8 | $64.2 |

Lease Commitments

At fiscal year-end 1999, the Company was committed to minimum rentals under noncancellable operating leases for fiscal years 2000 through 2004 and thereafter, as follows, in millions: $4.5, $3.0, $1.8, $1.4, $1.2, and $0.8. Rental expense for fiscal years 1999, 1998 and 1997, in millions, was $11.0, $10.1 and $9.9, respectively.

Contingencies

The Company has been named by the U.S. Environmental Protection Agency or third parties as a potentially responsible party under the Comprehensive Environmental Response Compensation and Liability Act of 1980, as amended ("CERCLA"), at eight sites where the Company is alleged to have shipped manufacturing waste for recycling or disposal. The Company is also involved in various stages of environmental investigation and/or remediation under the direction of, or in consultation with, federal, state and/or local agencies at certain current VMS or former Varian facilities (including facilities disposed of in connection with the Company's sale of its Electron Devices business during 1995, and the sale of its Thin Film Systems business during 1997). Under the terms of the Distribution Agreement, VI and VSEA are each obligated to indemnify the Company for one-third of these environmental-related investigation and remediation costs (after adjusting for any insurance proceeds realized or tax benefits recognized by the Company). Expenditures for environmental investigation and remediation amounted to $0.9 million in fiscal year 1999, $1.7 million in fiscal year 1998 and $0.8 million in fiscal year 1997, net of amounts that would have been borne by VI and VSEA.

For certain of these sites and facilities, various uncertainties make it difficult to assess the likelihood and scope of further investigation or remediation activities or to estimate the future costs of such activities if undertaken. As of October 1, 1999, the Company nonetheless estimated that the Company's future exposure (net

of VI and VSEA's indemnification obligations) for environmental-related investigation and remediation costs for these sites ranged in the aggregate from $12.4 million to $29.8 million. The time frame over which the Company expects to incur such costs varies with each site, ranging up to approximately 30 years as of October 1, 1999. Management believes that no amount in the foregoing range of estimated future costs is more probable of being incurred than any other amount in such range and therefore accrued $12.4 million in estimated environmental costs as of October 1, 1999. The amount accrued has not been discounted to present value.

As to other sites and facilities, the Company has gained sufficient knowledge to be able to better estimate the scope and costs of future environmental activities. As of October 1, 1999, the Company estimated that the Company's future exposure (net of VI and VSEA's indemnification obligations) for environmental-related investigation and remediation costs for these sites and facilities ranged in the aggregate from $22.9 million to $39.0 million. The time frame over which these costs are expected to be incurred varies with each site and facility, ranging up to approximately 30 years as of October 1, 1999. As to each of these sites and facilities, management determined that a particular amount within the range of estimated costs was a better estimate of the future environmental liability than any other amount within the range, and that the amount and timing of these future costs were reliably determinable. Together, these amounts totaled $26.7 million at October 1, 1999. The Company accordingly accrued $11.9 million, which represents its best estimate of the future costs discounted at 4%, net of inflation. This accrual is in addition to the $12.4 million described in the preceding paragraph.

At October 1, 1999, the Company's reserve for environmental liabilities, based upon future environmental related costs estimated by the Company as of that date, was calculated as follows:

| Fiscal Year: | Recurring Costs | Non-Recurring Costs | Total Anticipated Future Costs |
|---|---|---|---|
| 2000 | $ 1.2 | $2.8 | $ 4.0 |
| 2001 | 1.3 | 1.1 | 2.4 |
| 2002 | 1.4 | 0.0 | 1.4 |
| 2003 | 1.3 | 0.0 | 1.3 |
| 2004 | 1.4 | 0.0 | 1.4 |
| Thereafter | 27.2 | 1.4 | 28.6 |
| Total costs | $33.8 | $5.3 | 39.1 |
| Less imputed interest | | | (14.8) |
| Reserve amount | | | $ 24.3 |

The amounts set forth in the foregoing table are only estimates of anticipated future environmental-related costs, and the amounts actually spent may be greater or less than such estimates. The aggregate range of cost estimates reflects various uncertainties inherent in many environmental investigation and remediation activities and the large number of sites and facilities involved. The Company believes that most of these cost ranges will narrow as investigation and remediation activities progress. The Company believes that its reserves are adequate, but as the scope of its obligations becomes more clearly defined, these reserves (and the associated indemnification obligations of VI and VSEA) may be modified and related charges against earnings may be made.

Although any ultimate liability arising from environmental-related matters described herein could result in significant expenditures that, if aggregated and assumed to occur within a single fiscal year, would be material to the Company's financial statements, the likelihood of such occurrence is considered remote. Based on information currently available to management and its best assessment of the ultimate amount and timing of





environmental-related events (and assuming VI and VSEA satisfy their indemnification obligations), management believes that the costs of these environmental-related matters are not reasonably likely to have a material adverse effect on the consolidated financial statements of the Company.

The Company evaluates its liability for environmental-related investigation and remediation in light of the liability and financial wherewithal of potentially responsible parties and insurance companies with respect to which the Company believes that it has rights to contribution, indemnity and/or reimbursement (in addition to the obligations of VI and VSEA). Claims for recovery of environmental investigation and remediation costs already incurred, and to be incurred in the future, have been asserted against various insurance companies and other third parties. In 1992, the Company filed a lawsuit against 36 insurance companies with respect to most of the above-referenced sites and facilities. The Company received certain cash settlements during fiscal years 1995, 1996, 1997 and 1998 from defendants in that lawsuit. The Company has also reached an agreement with another insurance company under which the insurance company has agreed to pay a portion of the Company's past and future environmental-related expenditures, and the Company therefore has a $3.6 million receivable in Other Assets at October 1, 1999. The Company believes that this receivable is recoverable because it is based on a binding, written settlement agreement with a solvent and financially viable insurance company. Although the Company intends to aggressively pursue additional insurance and other recoveries, the Company has not reduced any liability in anticipation of recovery with respect to claims made against third parties.

The Company is a party to three related federal actions involving claims by independent service organizations ("ISOs") that the Company's policies and business practices relating to replacement parts violate the antitrust laws (the "ISOs Litigation"). The ISOs purchase replacement parts from the Company and compete with it for the servicing of linear accelerators made by the Company. In response to several threats of litigation regarding the legality of the Company's parts policy, the Company filed a declaratory judgment action in a U. S. District Court in 1996 seeking a determination that its new policies are legal and enforceable and damages against two of the ISOs for misappropriation of the Company's trade secrets, unfair competition, copyright infringement and related claims. Subsequently, four of the defendants filed separate claims in other jurisdictions raising issues allegedly related to those in the declaratory relief action and seeking injunctive relief against the Company and damages against the Company in the amount of $10 million for each plaintiff. The defendants' motion for a preliminary injunction in U. S. District Court in Texas with respect to the Company's policies was defeated. The ISOs defendants amended the complaint to include class action allegations, allege a variety of other anti-competitive business practices and filed a motion for class certification, which was heard by the U. S. District Court in Texas in July 1999. No decision, however, has been entered.

Following the Distribution, the Company retained the liabilities related to the medical systems business prior to the Distribution, including the ISOs Litigation. In addition, under the terms of the Distribution Agreement, the Company agreed to manage and defend liabilities related to legal proceedings and environmental matters arising from corporate or discontinued operations of the Company prior to the Distribution. Under the terms of the Distribution Agreement, VI and VSEA generally are each obligated to indemnify the Company for one-third of these liabilities (after adjusting for any insurance proceeds realized or tax benefits recognized by the Company), including certain environmental-related liabilities described above, and to fully indemnify the Company for liabilities arising from the operations of the business transferred to each prior to the Distribution. The availability of such indemnities will depend upon the future financial strength of VI and VSEA. No assurance can be given that the relevant company will be in a position to fund such indemnities. It is also possible that a court would disregard this contractual allocation of indebtedness, liabilities and obligations among the parties and require the Company to assume responsibility for obligations allocated to another party, particularly if such other party were to refuse or was unable to pay or perform any of its allocated obligations. In addition, the Distribution Agreement generally provides that if a court prohibits a company from satisfying its indemnification obligations, then such indemnification obligations will be shared equally between the two other companies.





The Company is also involved in certain other legal proceedings arising in the ordinary course of its business. While there can be no assurances as to the ultimate outcome of any litigation involving the Company, management does not believe any pending legal proceeding will result in a judgment or settlement that will have a material adverse effect on the Company's financial position, results of operations or cash flows.

Reorganization Charges

Fiscal year 1999 expenses included net reorganization charges of $29.7 million, of which $24.9 million was incurred as a result of the Distribution and $4.8 million was incurred as a result of the Company's restructuring of its X-ray Products segment by the closing of a manufacturing facility in Arlington Heights, Illinois to consolidate manufacturing at the Company's

existing facility in Salt Lake City, Utah. The $29.7 million net charge includes $34.3 million for retention bonuses for employee services provided prior to October 1, 1999, employee severance and executive compensation; $21.0 million for legal, accounting, printing and investment banking fees; $1.7 million for foreign taxes (excluding income taxes) resulting from the international reorganization of the Company's subsidiaries in connection with the Distribution; and $6.8 million in other costs associated with the Distribution and restructuring; partially offset by a $34.1 million gain on the sale of the Company's aircraft and long-term leasehold interests in certain of its Palo Alto facilities, together with the related buildings and other corporate assets.

The following table sets forth certain details associated with these net reorganization charges (in thousands of dollars):

| | Reorganization Costs as of October 1, 1999 | Cash (Payments) Receipts | Non-Cash Transactions | Accrual at October 1, 1999 |
|---|---|---|---|---|
| Retention bonuses, severance, and executive compensation | $34,307 | $(29,800) | $ -- | $4,507 |
| Legal, accounting, printing and investment banking fees | 20,982 | (19,190) | -- | 1,792 |
| Gain on sale of real estate and corporate assets | (34,098) | 50,948 | (16,850) | -- |
| Foreign taxes (excluding income taxes) | 1,700 | (18) | (1,006) | 676 |
| Other | 6,777 | (4,393) | (1,016) | 1,368 |
| | $29,668 | $ (2,453) | $(18,872) | $8,343 |

Purchase Business Combinations

During fiscal years 1999, 1998 and 1997, the Company acquired the assets and liabilities of two businesses. The consolidated financial statements include the operating results of each acquired business from the date of acquisition. Pro forma results of operations have not been presented, because the effects of these acquisitions were not material on either an individual or an aggregated basis.

Amounts allocated to goodwill are amortized on a straight-line basis over periods ranging from 7 to 40 years.





Summary of purchase transactions (dollars in millions):

| Entity Name | Consideration | Closing Date |
|---|---|---|
| Therapy Planning Division of Multimedia Medical Systems, Inc.--Brachytherapy | $ 7.5 | July 1999 |
| GE Medical Systems-Radiotherapy Service and Parts | $45.0 | December 1997 |

Industry Segments

In fiscal year 1999, the Company adopted Statement of Financial Accounting Standards No. 131 "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131"). SFAS 131 supercedes SFAS 14 "Financial Reporting for Segments of a Business Enterprise" replacing the "industry segment" approach with the "management" approach. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance as the source of the Company's reportable segments. SFAS 131 also requires disclosures about products and services, geographic areas, and major customers. The adoption of SFAS 131 did not affect results of operations or financial position but did affect the disclosure of segment information.

The Company's operations are grouped into two reportable segments: Oncology Systems and X-ray Products. These segments were determined based on how

management views and evaluates the Company's operations. The Company's Ginzton Technology Center (GTC) including its brachytherapy business, is reflected in an "other" category. Other factors included in segment determination were similar economic characteristics, distribution channels, manufacturing environment, technology and customers. The Company evaluates performance and allocates resources based on earnings from continuing operations before interest and taxes. The accounting policies of the reportable segments are the same as those disclosed in the summary of significant accounting policies.

Oncology Systems designs, manufactures, sells and services hardware and software products for radiation treatment of cancer, including linear accelerators, simulators and computer systems for planning cancer treatments and data management systems for radiation oncology centers. Oncology Systems also manufactures and markets related radiotherapy products such as imaging systems, information management systems, multi-leaf collimators, simulators and radiosurgery products. X-ray Products is involved in the design and manufacture of subsystems for diagnostic radiology, including x-ray-generating tubes and imaging subsystems. X-ray Products manufactures tubes for medical x-ray imaging applications including CT scanner, radiographic/fluoroscopic, special procedures; and mammography and industrial x-ray tubes consisting of analytical x-ray tubes used for x-ray fluorescence and diffraction as well as tubes used for non-destructive imaging and gauging. GTC, Varian Medical Systems' research and development facility for breakthrough technologies, also manufactures and sells the Company's brachytherapy products and services. In addition, GTC conducts externally funded contract research related to developing new medical technologies.

Corporate includes shared costs of legal, tax, accounting, human resources, real estate, insurance, information technology, treasury and other management costs. A portion of the indirect and common costs have been allocated through the use of estimates. Accordingly, the following information is provided for purposes of achieving an understanding of operations, but may not be indicative of the financial results of the reported segments were they independent organizations. In addition, comparisons of the Company's operations to similar operations of other companies may not be meaningful.

The Company operates various manufacturing and marketing operations outside the United States. Sales to customers located in Japan were $75 million in fiscal 1999, $68 million in fiscal 1998, and $67 million in fiscal





1997. For fiscal 1999, 1998 and 1997, no single country outside the United States accounted for more than 10% of total assets. Sales between geographic areas are accounted for at cost plus prevailing markups arrived at through negotiations between independent profit centers. Related profits are eliminated in consolidation.

Included in the total of United States sales are export sales of $112 million in fiscal 1999, $97 million in fiscal 1998, and $108 million in fiscal 1997. No single customer represents 10% or more of the Company's total sales. Sales under prime contracts from the U.S. Government were approximately $4.4 million in fiscal 1999, $6.1 million in fiscal 1998, and $4.2 million in fiscal 1997.

Industry Segments

| | Sales | | | Earnings from Continuing Operations before Taxes | | | Total Assets | | Capital Expenditures* | | | Depreciation & Amortization* | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1999 | 1998 | 1997 | 1999 | 1998 | 1997 | 1999 | 1998 | 1999 | 1998 | 1997 | 1999 | 1998 | 1997 |
| | (Dollars in millions) | | | | | | | | | | | | | |
| Oncology Systems..... | $459 | $405 | $337 | $70 | $60 | $47 | $333 | $ 302 | $10 | $ 7 | $ 5 | $ 9 | $ 8 | $ 7 |
| X-ray Products..... | 123 | 131 | 130 | 11 | 20 | 23 | 86 | 79 | 8 | 6 | 6 | 9 | 7 | 7 |
| Other..... | 8 | 5 | 7 | (8) | (9) | (7) | 16 | 6 | 3 | 1 | 1 | 1 | 1 | 1 |
| Total Industry Segments..... | 590 | 541 | 474 | 73 | 71 | 63 | 435 | 387 | 21 | 14 | 12 | 19 | 16 | 15 |
| General corporate and other..... | -- | -- | -- | (49) | (33) | (31) | 104 | 831 | 7 | 6 | 12 | 5 | 6 | 7 |
| Interest, net..... | -- | -- | -- | (6) | (2) | (3) | -- | -- | -- | -- | -- | -- | -- | -- |
| Total Company..... | $590 | $541 | $474 | $18 | $36 | $29 | $539 | $1,218 | $28 | $20 | $24 | $24 | $22 | $22 |

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* Amounts may not agree to financial statements due to amounts associated

with discontinued operations.

Geographic Information

| | Sales | | | Long-Lived Assets | |
|---|---|---|---|---|---|
| | 1999 | 1998 | 1997 | 1999 | 1998 |
| | (Dollars in millions) | | | | |
| United States | $267 | $234 | $223 | $124 | $288 |
| International | 323 | 307 | 251 | 33 | 91 |
| Total Company | $590 | $541 | $474 | $157 | $379 |

Sales are based on final destination of products sold.





Event (Unaudited) Subsequent to the Date of the Report of Independent Accountants

In November 1999, the Company obtained a $50 million committed revolving credit facility.





Quarterly Financial Data (Unaudited)

| | 1999 | | | | | 1998 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter | Total Year | First Quarter | Second Quarter | Third Quarter | Fourth Quarter | Total Year |
| | (Dollars in millions except per share amounts) | | | | | | | | | |
| Sales | $105.0 | 149.3 | 144.5 | 191.6 | 590.4 | $ 99.0 | 131.5 | 131.5 | 179.5 | 541.5 |
| Gross Profit | $ 32.8 | 49.4 | 51.3 | 76.5 | 210.0 | $ 33.6 | 42.8 | 45.9 | 72.9 | 195.2 |
| Net Earnings (Loss) Continuing Operations | $ (2.0) | (10.2) | 6.6 | 13.8 | 8.2 | $ (4.3) | 4.5 | 8.8 | 17.1 | 26.1 |
| Discontinued Operations | (0.4) | (30.8) | 0.0 | (1.2) | (32.4) | 24.0 | 18.5 | 9.7 | (4.5) | 47.7 |
| Net Earnings (Loss) | $ (2.4) | (41.0) | 6.6 | 12.6 | (24.2) | $ 19.7 | 23.0 | 18.5 | 12.6 | 73.8 |
| Net Earnings (Loss) Per Share--Basic | | | | | | | | | | |
| Continuing Operations | $(0.07) | (0.34) | 0.22 | 0.46 | 0.27 | $(0.14) | 0.15 | 0.29 | 0.58 | 0.87 |
| Discontinued Operations | (0.01) | (1.02) | 0.00 | (0.05) | (1.07) | 0.80 | 0.62 | 0.33 | (0.15) | 1.60 |
| Basic | $(0.08) | (1.36) | 0.22 | 0.41 | (0.80) | $ 0.66 | 0.77 | 0.62 | 0.43 | 2.47 |
| Net Earnings (Loss) Per Share--Diluted | | | | | | | | | | |
| Continuing Operations | $(0.07) | (0.34) | 0.21 | 0.45 | 0.27 | $(0.14) | 0.15 | 0.29 | 0.57 | 0.86 |
| Discontinued Operations | (0.01) | (1.02) | 0.00 | (0.04) | (1.06) | 0.78 | 0.60 | 0.32 | (0.15) | 1.57 |
| Basic | $(0.08) | (1.36) | 0.21 | 0.41 | (0.79) | $ 0.64 | 0.75 | 0.61 | 0.42 | 2.43 |

The four quarters for net earnings (loss) per share may not add for the year

because of the different number of shares outstanding during the year.

Net earnings (loss) from continuing operations for the first through the fourth quarters of fiscal year 1999 include net after tax reorganization related charges (income) of $3.0 million, $23.1 million, $0.3 million, and ($0.7) million, respectively, and related diluted (earnings) loss per share of $0.10, $0.77, $0.01, and ($0.02), respectively.

Market for the Registrant's Common Equity and Related Stockholder Matters (Unaudited)

The following table sets forth, for the periods indicated, the highest and lowest closing sales prices for the Common Stock as reported in the consolidated transaction reporting system for the New York Stock Exchange in fiscal year 1998 and in the portion of the fiscal year 1999 that was prior to the Distribution. The Company's Common Stock is traded on the New York Stock Exchange and Pacific Exchange under the symbol VAR.

| | High | Low |
|---|---|---|
| Fiscal 1998 | | |
| First Quarter | $66 3/4 | $47 3/4 |
| Second Quarter | 58 3/8 | 47 1/2 |
| Third Quarter | 53 15/16 | 38 3/16 |
| Fourth Quarter | 43 | 31 13/16 |
| Fiscal Year 1999 | | |
| First Quarter | 41 1/16 | 32 7/16 |
| Second Quarter | 43 | 31 3/4 |





On April 2, 1999, Varian distributed to its stockholders all of the outstanding shares of common stock of each of VI and USEA. Following the Distribution, the highest and lowest closing sales prices for the Common Stock as so reported were:

| | High | Low |
|---|---|---|
| Fiscal Year 1999 | | |
| Third Quarter | $25 1/4 | $16 5/8 |
| Fourth Quarter | 24 3/16 | 19 7/16 |

Varian declared cash dividends of $0.09 in the first quarter of fiscal year 1998, and $0.10 in each quarter thereafter through the first quarter of fiscal year 1999. Since the Distribution, the Company has not paid any dividends on the Common Stock and does not currently anticipate paying dividends on the Common Stock for the foreseeable future. Further, the existing term loans of the Company's financing agreements contain provisions that limit the ability of the Company to pay dividends.



## REPORT OF INDEPENDENT ACCOUNTANTS ON FINANCIAL STATEMENT SCHEDULE

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

Our audits of the consolidated financial statements referred to in our report dated November 4, 1999 appearing on page F-2 of this Form 10-K also included an audit of the financial statement schedule listed in Item 14(a)(2) of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

San Jose, California
November 4, 1999

SCHEDULE II

VARIAN MEDICAL SYSTEMS, INC. AND SUBSIDIARY COMPANIES

VALUATION AND QUALIFYING ACCOUNTS (/1/)
for the fiscal years ended 1999, 1998, and 1997
(Dollars in Thousands)

| Description | Balance at Beginning of Period | Charged to Costs and Expenses | Deductions | | Balance at End of Period |
|---|---|---|---|---|---|
| | | | Description | Amount | |
| ALLOWANCE FOR DOUBTFUL NOTES & ACCOUNTS RECEIVABLE: | | | | | |
| Fiscal Year Ended 1999.. | $ 2,644 | $ 2,704 | Write-offs & Adjustments | $ 4,210(/2/) | $ 1,138 |
| Fiscal Year Ended 1998.. | $ 2,715 | $ 3,020 | Write-offs & Adjustments | $ 3,091 | $ 2,644 |
| Fiscal Year Ended 1997.. | $ 2,309 | $ 1,468 | Write-offs & Adjustments | $ 1,062 | $ 2,715 |
| ESTIMATED LIABILITY FOR PRODUCT WARRANTY: | | | | | |
| Fiscal Year Ended 1999.. | $44,153 | $56,389 | Actual Warranty Expenditures | $82,390(/3/) | $18,152 |
| Fiscal Year Ended 1998.. | $37,620 | $59,433 | Actual Warranty Expenditures | $52,900 | $44,153 |
| Fiscal Year Ended 1997.. | $49,251 | $42,994 | Actual Warranty Expenditures | $54,625(/4/) | $37,620 |

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(1) As to column omitted the answer is "none."
(2) Includes a $2,420 deduction due to the spin-off of the Company's instruments and semiconductor businesses on April 2, 1999.
(3) Includes a $22,437 deduction due to the spin-off of the Company's instruments and semiconductor businesses on April 2, 1999.
(4) Includes a $5,226 deduction due to the sale of Thin Film Systems.



EXHIBIT INDEX

Set forth below is a list of exhibits that are being filed or incorporated by reference into this Form 10-K:

| Exhibit Number | Exhibit |
|---|---|
| 2 | Amended and Restated Distribution Agreement, dated as of January 14, 1999, by and among Varian Associates, Inc. (which has been renamed Varian Medical Systems, Inc.), Varian, Inc. and Varian Semiconductor Equipment Associates, Inc. (incorporated by reference to Exhibit 2 to the registrant's Form 8-K Current Report dated as of April 2, 1999, File No. 1-7598). |
| 3-A.1 | Registrant's Restated Certificate of Incorporation, as amended.* |
| 3-A.2 | Certificate of Designation and Terms of Participating Preferred Stock.* |
| 3-B | Registrant's By-Laws, as amended.* |
| 4.1 | Specimen Common Stock Certificate.* |
| 10.1+ | Registrant's Omnibus Stock Plan.* |
| 10.2+ | Registrant's Management Incentive Plan.* |
| 10.3+ | Registrant's form of Indemnity Agreement with Directors and Executive Officers.* |
| 10.4+ | Registrant's form of Change in Control Agreement with certain Executive Officers other than the Chief Executive Officer and the |

| | |
|---|---|
| | Chief Financial Officer.* |
| 10.5+ | Registrant's Change in Control Agreement with the Chief Executive Officer.* |
| 10.6+ | Registrant's Change in Control Agreement with the Chief Financial Officer.* |
| 10.7+ | Registrant's Change in Control Agreement with General Counsel. |
| 10.8 | Amended and Restated Note Purchase and Private Shelf Agreement, dated as of April 1, 1999, between Registrant and Prudential Insurance Company of America (certain exhibits and schedules omitted).* |
| 10.9 | Employee Benefits Allocation Agreement, dated April 2, 1999, by and among Varian Associates, Inc. (which has been renamed Varian Medical Systems, Inc.), Varian, Inc. and Varian Semiconductor Equipment Associates, Inc. (incorporated by reference to Exhibit No. 99.1 to the registrant's Form 8-K Current Report dated as of April 2, 1999, File No. 1-7598). |
| 10.10 | Intellectual Property Agreement, dated April 2, 1999, by and among Varian Associates, Inc. (which has been renamed Varian Medical Systems, Inc.), Varian, Inc. and Varian Semiconductor Equipment Associates, Inc. (incorporated by reference to Exhibit No. 99.2 to the registrant's Form 8-K Current Report dated as of April 2, 1999, File No. 1-7598). |
| 10.11 | Tax Sharing Agreement, dated April 2, 1999, by and among Varian Associates, Inc. (which has been renamed Varian Medical Systems, Inc.), Varian, Inc. and Varian Semiconductor Equipment Associates, Inc. (incorporated by reference to Exhibit No. 99.3 to the registrant's Form 8-K Current Report dated as of April 2, 1999, File No. 1-7598). |
| 10.12 | Transition Services Agreement, dated April 2, 1999, by and among Varian Associates, Inc. (which has been renamed Varian Medical Systems, Inc.), Varian, Inc. and Varian Semiconductor Equipment Associates, Inc. (incorporated by reference to Exhibit No. 99.4 to the registrant's Form 8-K Current Report dated as of April 2, 1999, File No. 1-7598). |
| 10.13+ | Amended and Restated Severance Agreement between the registrants and Joseph B. Phair dated as of August 20, 1999. |
| 10.14+ | Registrant's Supplemental Retirement Plan |
| 10.15+ | Description of Certain Compensatory Arrangements between registrants and Directors |
| 10.16+ | Description of Certain Compensatory Arrangements between registrant and executive officers |
| 21 | List of Subsidiaries |
| 23 | Consent of Independent Accountants |
| 27.1 | Financial Data Schedule for the fiscal year ended October 1, 1999 |
| 27.2 | Restated Financial Data Schedule for the fiscal year ended October 2, 1998. |
| 27.3 | Restated Financial Data Schedule for the fiscal year ended September 26, 1997. |

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* Incorporated by reference from the exhibit of the same number to the registrant's Form 10-Q Quarterly Report for the quarter ended April 2, 1999, File No. 1-7598.

\+ Management contract or compensatory arrangement.

EXHIBIT 10.7

CHANGE IN CONTROL AGREEMENT
SENIOR EXECUTIVES (Chief Financial Officer and General Counsel)

SECOND AMENDED AND RESTATED CHANGE IN CONTROL AGREEMENT

THIS SECOND AMENDED AND RESTATED CHANGE IN CONTROL AGREEMENT ("Agreement") is entered into effective as of August 20, 1999, by and between VARIAN MEDICAL SYSTEMS, INC., a Delaware corporation (the "Company")/1/, and Joseph B. Phair, an employee of the Company ("Employee").

The Company's Board of Directors (the "Board") has determined that it is in the best interest of the Company and its stockholders for the Company to agree to pay Employee termination compensation in the event Employee should leave the employ of the Company under the circumstances described below. The Board recognizes that the possibility of a proposal from a third person, whether or not solicited by the Company, concerning a possible "Change in Control" of the Company (as such language is defined in Section 3(d)) will be unsettling to Employee. Therefore, the arrangements set forth in this Agreement are being made to help assure a continuing dedication by Employee to Employee's duties to the Company notwithstanding the proposal or occurrence of a Change in Control. The Board believes it imperative, should the Company receive any proposal from a third party, that Employee, without being influenced by the uncertainties of Employee's own situation, be able to assess and advise the Board whether such proposals are in the best interest of the Company and its stockholders, and to enable Employee to take action regarding such proposals as the Board might determine to be appropriate. The Board also wishes to demonstrate to key personnel that the Company desires to enhance management relations and its ability to retain and, if needed, to attract new management, and intends to ensure that loyal and dedicated management personnel are treated fairly.

In view of the foregoing, the Company and Employee agree as follows:

1. EFFECTIVE DATE AND TERM OF AGREEMENT.

This Agreement is effective and binding on the Company and Employee as of the date hereof; provided, however, that, subject to Section 2(d), the provisions of Sections 3 and 4 shall become operative only upon the Change in Control Date.

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1 "Company" shall include the Company, any successor to the Company's business and/or assets, and any party which executes and delivers the agreement required by Section 6(e) or which otherwise becomes bound by the terms and conditions of this Agreement by operation of law or otherwise.

2. EMPLOYMENT OF EMPLOYEE.

(a) Except as provided in Sections 2(b), 2(c) and 2(d), nothing in this Agreement shall affect any right which Employee may otherwise have to terminate Employee's employment, nor shall anything in this Agreement affect any right which the Company may have to terminate Employee's employment at any time in any lawful manner.

(b) In the event of a Potential Change in Control, to be entitled to receive the benefits provided by this Agreement, Employee will not Voluntarily leave the employ of the Company, and will continue to perform Employee's regular duties and the services specified in the recitals of this Agreement until the Change in Control Date. Should Employee voluntarily terminate employment prior to the Change in Control Date, this Agreement shall lapse upon such termination and be of no further force or effect.

(c) If Employee's employment terminates on or after the Change in Control Date, the Company will provide to Employee the payments and benefits as provided in Sections 3 and 4.

(d) If Employee's employment is terminated by the Company prior to the Change in Control Date but on or after a Potential Change in Control Date, then the Company will provide to Employee the payments and benefits as provided in Sections 3 and 4 unless the Company reasonably demonstrates that Employee's termination of employment neither (i) was at the request of a third party who has taken steps reasonably calculated to effect a Change in Control nor (ii) arose in connection with or in anticipation of a Change in Control. Solely for purposes of determining the timing of payments and the provision of benefits in Sections 3 and 4 under the circumstances described in this Section 2(d), Employee's date of termination shall be deemed to be the Change in Control Date.

3. TERMINATION FOLLOWING CHANGE IN CONTROL.

(a) If a Change in Control shall have occurred, Employee shall be entitled to the benefits provided in Section 4 upon the subsequent termination of Employee's employment within the applicable period set forth in Section 4 unless such termination is due to Employee's death, Retirement or Disability or is for Cause or is effected by Employee other than for Good Reason (as such terms are defined in Section 3(d)).

(b) If following a Change in Control, Employee's employment is terminated by reason of Employee's death or Disability, Employee shall be entitled to death or long-term disability benefits from the Company no less favorable than the most favorable benefits to which Employee would have been entitled had the death or Disability occurred at any time during the period commencing one (1) year prior to the Change in Control.

(c) If Employee's employment shall be terminated by the Company for Cause or by Employee other than for Good Reason during the term of this Agreement, the Company shall pay Employee's Base Salary through the date of termination at the rate in effect at the time notice of termination is given, and the Company shall have no further obligations to Employee under this



Agreement.

(d) For purposes of this Agreement:

"Base Salary" shall mean the annual base salary paid to Employee immediately prior to a Change in Control, provided that such amount shall in no event be less than the annual base salary paid to Employee during the one (1) year period immediately prior to the Change in Control.

A "Change in Control" shall be deemed to have occurred if:

(i) Any individual or group constituting a "person", as such term is used in Sections 13(d) and 14(d)(2) of the Exchange Act (other than (A) the Company or any of its subsidiaries or 03) any trustee or other fiduciary holding securities under an employee benefit plan of the Company or of any of its subsidiaries), is or becomes the beneficial owner, directly or indirectly, of securities of the Company representing thirty percent (30%) or more of the combined voting power of the Company's outstanding securities then entitled ordinarily (and apart from rights accruing under special circumstances) to vote for the election of directors; or

(ii) Continuing Directors cease to constitute at least a majority of the Board; or

(iii) there occurs a reorganization, merger, consolidation or other corporate transaction involving the Company (a "Transaction"), in each case with respect to which the stockholders of the Company immediately prior to such Transaction do not, immediately after the Transaction, own more than 50% of the combined voting power of the Company or other corporation resulting from such Transaction; or

(iv) all or substantially all of the assets of the Company are sold, liquidated or distributed;

provided, however, that a "Change in Control" shall not be deemed to have occurred under this Agreement if, prior to the occurrence of a specified event that would otherwise constitute a Change in Control hereunder, the disinterested Continuing Directors then in office, by a majority vote thereof, determine that the occurrence of such specified event shall not be deemed to be a Change in Control with respect to Employee hereunder if the Change in Control results from actions or events in which Employee is a participant in a capacity other than solely as an officer, employee or director of the Company.

"Change in Control Date" shall mean the date on which a Change in Control occurs.



"Cause" shall mean:

(i) The continued willful failure of Employee to perform Employee's duties to the Company (other than any such failure resulting from Employee's incapacity due to physical or mental illness) after written notice thereof (specifying the particulars thereof in reasonable detail) and a reasonable opportunity to be heard and cure such failure are given to Employee by the Board or a committee thereof; or

(ii) The willful commission by Employee of a wrongful act that caused or was reasonably likely to cause substantial damage to the Company, or an act of fraud in the performance of Employee's duties on behalf of the Company; or

(iii) The conviction of Employee for commission of a felony in connection with the performance of Employee's duties on behalf of the Company; or

(iv) The order of a federal or state regulatory authority having jurisdiction over the Company or its operations or by a court of competent jurisdiction requiting the termination of Employee's employment by the Company.

"Continuing Directors" shall mean the directors of the Company in office on the date hereof and any successor to any such director who was nominated or selected by a majority of the Continuing Directors in office at the time of the director's nomination or selection and who is not an "affiliate" or "associate" (as defined in Regulation 12B under the Exchange Act) of any person who is the beneficial owner, directly or indirectly, of securities representing ten percent (10%) or more of the combined voting power of the Company's outstanding securities then entitled ordinarily to vote for the election of directors.

"Disability" shall mean Employee's incapacity due to physical or mental illness such that Employee shall have become qualified to receive benefits under the Company's long-term disability plan as in effect on the date of the Change in Control.

"Dispute" shall mean, in the case of termination of Employee's employment for Disability or Cause, that Employee challenges the existence of Disability or Cause, and in the case of termination of Employee's employment for Good Reason, that the Company challenges the existence of Good Reason for termination of Employee's employment.

"Exchange Act" means the Securities Exchange Act of 1934, as amended.

"Equivalent Position" shall mean an employment position that:

(i) is in a substantive area of competence (e.g., finance, accounting, legal, operations management or human resources) that is consistent with Employee's experience and not materially different from the substantive area of competence of Employee's position with the Company prior to the Change in Control;



(ii) requires that Employee serve in a role and perform duties that are functionally equivalent to the role and duties performed by Employee for the Company prior to the Change in Control;

(iii) carries a title that does not connote a lesser rank or corporate role than is connoted by Employee's title with the Company prior to the Change in Control;

(iv) does not constitute a material, adverse change in Employee's responsibilities or duties, when compare to Employee's responsibilities or duties with the Company prior to the Change in Control;

(v) requires that Employee be deemed an executive officer (for purposes of the rules promulgated under Section 16 of the Securities Exchange Act of 1934) of a publicly-traded successor entity having net assets or annual revenues that are no less than those of the Company prior to the Change in Control; and

(vi) has Employee reporting directly to the Chief Executive Officer of the
combined or acquiring company.

"Good Reason" shall mean:

(i) The assignment to Employee of a position, title, responsibilities or duties such that he no longer holds an Equivalent Position; or

(ii) A reduction of Employee's total compensation as the same may have been increased from time to time after the Change in Control Date other than (A) a reduction implemented with the consent of Employee or (B) a reduction that is generally comparable (proportionately) to compensation reductions imposed on senior executives of the Company generally; or

(iii) The failure to provide to Employee the benefits and perquisites, including participation on a comparable basis in the Company's stock option, incentive, and other similar plans in which employees of the Company of comparable title and salary grade participate, as were provided to Employee immediately prior to a Change in Control, or with a package of benefits and perquisites that are substantially comparable in all material respects to such benefits and perquisites provided prior to the Change in Control; or

(iv) The relocation of the office of the Company where Employee is employed immediately prior to the Change in Control Date (the "CIC Location") to a location which is more than 50 miles away from the CIC Location or the Company's requiring Employee to be based more than 50 miles away from the CIC Location (except for required travel on the Company's business to an extent substantially consistent with Employee's customary business travel obligations in the ordinary course of business prior to the Change in Control Date);

(v) The failure of the Company to obtain promptly upon any Change in

Control the express written assumption of an agreement to perform this Agreement by any successor as contemplated in Section 6(e); or

(vi) The attempted termination of Employee's employment for Cause on grounds insufficient to constitute a basis of termination for Cause under this Agreement; or

(vii) The failure of the Company to promptly make any payment into escrow when so required by Section 3(f).

"Potential Change in Control" shall mean the earliest to occur of (a) the execution of an agreement or letter of intent, the consummation of the transactions described in which would result in a Change in Control, (b) the approval by the Board of a transaction or series of transactions, the consummation of which would result in a Change in Control, or (c) the public announcement of a tender offer for the Company's voting stock, the completion of which would result in a Change in Control; provided, that no such event shall be a "Potential Change in Control" unless (i) in the case of any agreement or letter of intent described in clause (a), the transaction described therein is subsequently consummated by the Company and the other party or parties to such agreement or letter of intent and thereupon constitutes a "Change in Control", (ii) in the case of any Board-approved transaction described in clause (b), the transaction so approved is subsequently consummated and thereupon constitutes a "Change in Control" or (iii) in the case of any tender offer described in clause (c), such tender offer is subsequently completed and such completion thereupon constitutes a "Change in Control".

"Potential Change in Control Date" shall mean the date on which a Potential Change in Control occurs.

"Retirement" shall mean Employee's actual retirement after reaching the normal or early retirement date provided for in the Company's Retirement and Profit-Sharing Program as in effect on the date of Employee's termination of employment.

(e) Any termination of employment by the Company or by Employee shall be communicated by written notice, specify the date of termination, state the specific basis for termination and set forth in reasonable detail the facts and circumstances of the termination in order to provide a basis for determining the entitlement to any payments under this Agreement.

(f) If within thirty (30) days after notice of termination is given, the party to whom the notice was given notifies the other party that a Dispute exists, the parties will promptly pursue resolution of such Dispute with reasonable diligence; provided, however, that pending resolution of any such Dispute, the Company shall pay 75% of any amounts which would otherwise be due Employee pursuant to Section 4 if such Dispute did not exist into escrow pending resolution of such Dispute and pay 25% of such amounts to Employee. Employee agrees to return to the Company any such amounts to which it is ultimately determined that he is not entitled.



4. PAYMENTS AND BENEFITS UPON TERMINATION.

(a) If within eighteen (18) months after a Change in Control, the Company terminates Employee's employment other than by reason of Employee's death, Disability, Retirement or for Cause, or if Employee terminates Employee's employment for Good Reason, then the Employee shall be entitled to the following payments and benefits:

(i) The Company shall pay to Employee as compensation for services rendered, no later than five (5) business days following the date of termination, a lump sum severance payment equal to 2.50 multiplied by the sum of: (A) Employee's Base Salary; (B) the highest annual bonus that was paid to Employee in any of the three fiscal years ending prior to the date of termination under the Company's Management Incentive Plan (the "MIP") or Varian Associates, Inc.'s Management Incentive Plan; and (C) the highest cash bonus for a performance period of more than one fiscal year that was paid to Employee in any of the three fiscal years ending prior to the date of termination under the MIP.

(ii) The Company shall pay to Employee as compensation for services rendered, no later than five (5) business days following the date of termination, a lump sum payment equal to a pro rata portion (based on the number of days elapsed during the fiscal year and/or other bonus performance period in which the termination occurs) of Employee's target bonus under the MIP for the fiscal year and for any other partially completed bonus performance period in which the termination occurs.

(iii) All waiting periods for the exercise of any stock options granted to Employee and all conditions or restrictions of any restricted stock granted to Employee shall terminate, and all such options shall be exercisable in full according to their terms, and the restricted stock shall be transferred to Employee as soon as reasonably practicable thereafter.

(iv) Employee's participation as of the date of termination in the life, medical/dental/vision and disability insurance plans and financial/tax counseling plan of the Company shall be continued on the same terms (including any cost sharing) as if Employee were an employee of the Company (or equivalent benefits provided) until the earlier of Employee's commencement of substantially equivalent full-time employment with a new employer or twenty-four (24) months after the date of termination; provided, however, that after the date of termination, Employee shall no longer be entitled to receive Company-paid executive physicals or, upon expiration of the applicable memberships, Company-paid airline memberships. In the event Employee shall die before the expiration of the period during which the Company is required to continue Employee's participation in such insurance plans, the participation of Employee's surviving spouse and family in the Company's insurance plans shall continue throughout such period.

(v) Employee may elect upon termination to purchase any automobile then in the possession of Employee and subject to a lease of which the Company is the lessor by payment to the Company of the residual value set forth in the lease, without any increase for remaining lease payments during the term or other lease breakage costs. Employee may elect to



have any such payment deducted from any payments due the Employee hereunder.

(vi) All payments and benefits provided under this Agreement shall be subject to applicable tax withholding.

(b) Following Employee's termination of employment for any reason, the Company shall have the unconditional right to reduce any payments owed to Employee hereunder by the amount of any due and unpaid principal and interest on any loans by the Company to Employee and Employee hereby agrees and consents to such right on the part of the Company.

5. GROSS-UP PAYMENT.

(a) Notwithstanding anything herein to the contrary, if it is determined that any Payment would be subject to the excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code"), or any interest or penalties with respect to such excise tax (such excise tax, together with any interest or penalties thereon, is herein referred to as an "Excise Tax"), then Employee shall be entitled to an additional payment (a "Gross-Up Payment") in an amount that will place Employee in the same after-tax economic position that Employee would have enjoyed if the Excise Tax had not applied to the Payment. The amount of the Gross-Up Payment shall be determined by a nationally-recognized independent public accounting firm designated by agreement between Employee and the Company (the "Accounting Firm"). No Gross-Up Payments shall be payable hereunder if the Accounting Firm determines that the Payments are not subject to an Excise Tax.

"Payment" means (i) any amount due or paid to Employee under this Agreement, (ii) any amount that is due or paid to Employee under any plan, program or arrangement of the Company and its subsidiaries and (iii) any amount or benefit that is due or payable to Employee under this Agreement or under any plan, program or arrangement of the Company and its subsidiaries not otherwise covered under clause (i) or (ii) hereof which must reasonably be taken into account under Section 280G of the Code in determining the amount the "parachute payments" received by Employee, including, without limitation, any amounts which must be taken into account under Section 280G of the Code as a result of (A) the acceleration of the vesting of any option, restricted stock or other equity award, (B) the acceleration of the time at which any payment or benefit is receivable by Employee or (C) any contingent severance or other amounts that are payable to Employee.

(b) Subject to the provisions of Section 5(c), all determinations required under this Section 5, including whether a Gross-Up Payment is required, the amount of the Payments constituting excess parachute payments, and the amount of the Gross-Up Payment, shall be made by the Accounting Firm, which shall provide detailed supporting calculations both to Employee and the Company within fifteen days of the date reasonably requested by Employee or the Company on which a determination under this Section 5 is necessary or advisable. The Company shall pay to Employee the initial Gross-Up Payment within 5 days of the receipt by Employee and the Company of the determination of the Accounting Finn. If the Accounting Finn determines that no Excise Tax is payable by Employee, the Company shall cause its



accountants to provide Employee with an opinion that the Accounting Firm has substantial I authority under the Code not to report an Excise Tax on Employee's federal income tax return. Any determination by the Accounting Firm shall be binding upon Employee and the Company. If the initial Gross-Up Payment is insufficient to cover the amount of the Excise Tax that is ultimately determined to be owing by Employee with respect to any Payment (hereinafter an "Underpayment"), the Company, after exhausting its remedies under Section 5(c)

below, shall promptly pay to Employee an additional Gross-Up Payment in respect of the Underpayment.

(c) Employee shall notify the Company in writing of any claim by the Internal Revenue Service that, if successful, would require the payment by the Company of a Gross-Up Payment. Such notice shall be given as soon as practicable after Employee knows of such claim and shall apprise the Company of the nature of the claim and the date on which the claim is requested to be paid. Employee agrees not to pay the claim until the expiration of the thirty (30) day period following the date on which Employee notifies the Company, or such shorter period ending on the date the Taxes with respect to such claim are due (the "Notice Period"). If the Company notifies Employee in writing prior to the expiration of the Notice Period that it desires to contest the claim, Employee shall: (i) give the Company any information reasonably requested by the Company relating to the claim; (ii) take such action in connection with the claim as the Company may reasonably request, including, without limitation, accepting legal representation with respect to such claim by an attorney reasonably selected by the Company and reasonably acceptable to Employee; (iii) cooperate with the Company in good faith in contesting the claim; and (iv) permit the Company to participate in any proceedings relating to the claim. Employee shall permit the Company to control all proceedings related to the claim and, at its option, permit the Company to pursue or forgo any and all administrative appeals, proceedings, hearings, and conferences with the taxing authority in respect of such claim. If requested by the Company, Employee agrees either to pay the tax claimed and sue for a refund or contest the claim in any permissible manner and to prosecute such contest to a determination before any administrative tribunal, in a court of initial jurisdiction and in one or more appellate courts as the Company shall determine; provided, however, that, if the Company directs Employee to pay such claim and pursue a retired, the Company shall advance the amount of such payment to Employee on an after-tax and interest-free basis (an "Advance"). The Company's control of the contest related to the claim shall be limited to the issues related to the Gross-Up Payment and Employee shall be entitled to settle or contest, as the case may be, any other issues raised by the Internal Revenue Service or other taxing authority. If the Company does not notify Employee in writing prior to the end of the Notice Period of its desire to contest the claim, the Company shall pay to Employee an additional Gross-Up Payment in respect of the excess parachute payments that are the subject of the claim, and Employee agrees to pay the amount of the Excise Tax that is the subject of the claim to the applicable taxing authority in accordance with applicable law.

(d) If, after receipt by Employee of an Advance, Employee becomes entitled to a retired with respect to the claim to which such Advance relates, Employee shall pay the Company the amount of the retired (together with any interest paid or credited thereon after Taxes applicable thereto). If, after receipt by Employee of an Advance, a determination is made that Employee shall not be entitled to any refund with respect to the claim and the Company does not promptly notify Employee of its intent to contest the denial of refund, then the amount of the



Advance shall not be required to be repaid by Employee and the amount thereof shall offset the amount of the additional Gross-Up Payment then owing to Employee.

(e) The Company shall indemnify Employee and hold Employee harmless, on an after-tax basis, from any costs, expenses, penalties, fines, interest or other liabilities ("Losses") incurred by Employee with respect to the exercise by the Company of any of its rights under this Section 5, including, without limitation, any Losses related to the Company's decision to contest a claim or any imputed income to Employee resulting from any Advance or action taken on Employee's behalf by the Company hereunder. The Company shall pay all legal fees and expenses incurred under this Section 5, and shall promptly reimburse Employee for the reasonable expenses incurred by Employee in connection with any actions taken by the Company or required to be taken by Employee hereunder. The Company shall also pay all of the fees and expenses of the Accounting Firm, including, without limitation, the fees and expenses related to the opinion referred to in Section 5(b).

6. GENERAL.
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(a) Employee shall retain in confidence under the conditions of the Company's confidentiality agreement with Employee any proprietary or other confidential information known to Employee concerning the Company and its business so long as such information is not publicly disclosed and disclosure is not required by an order of any governmental body or court. If required, Employee shall return to the Company any memoranda, documents or other materials proprietary to the Company.

(b) While employed by the Company and following the termination of such employment (other than a termination of employment by Employee for Good Reason or by the Company other than for Cause) for a period of two (2) years, Employee shall not, whether for Employee's own account or for the account of any other individual, partnership, firm, corporation or other business organization, intentionally solicit, endeavor to entice away from the Company or a subsidiary

of the Company (each, a "Protected Party"), or otherwise interfere with the relationship of a Protected Party with, any person who is employed by a Protected Party or any person or entity who is, or was within the then most recent twelve (12) month period, a customer or client of a Protected Party.

Employee acknowledges that a breach of any of the covenants contained in this Section 6(b) may result in material irreparable injury to the Company for which there is no adequate remedy at law, that it may not be possible to measure damages for such injuries precisely and that, in the event of such a breach, any payments remaining under the terms of this Agreement shall cease and the Company may be entitled to obtain a temporary restraining order and/or a preliminary or permanent injunction restraining Employee from engaging in activities prohibited by this Section 6(b) or such other relief as may be required to specifically enforce any of the covenants in this Section 6(b). Employee agrees to and hereby does submit to in personam jurisdiction before each and every such court in the State of California, County of Santa Clara, for that purpose. This Section 6(b) shall survive any termination of this Agreement.



(c) If litigation is brought by Employee to enforce or interpret any provision contained in this Agreement, the Company shall indemnify Employee for Employee's reasonable attorney's fees and disbursements incurred in such litigation and pay prejudgment interest on any money judgment obtained by Employee calculated at the prime rate of interest in effect from time to time at the Bank of America, San Francisco, from the date that payment should have been made under the Agreement, provided that Employee shall not have been found by the court in which such litigation is pending to have had no cause in bringing the action, or to have acted in bad faith, which finding must be final with the time to appeal therefrom having expired and no appeal having been taken.

(d) Except as provided in Section 4, the Company's obligation to pay to Employee the compensation and to make the arrangements provided in this Agreement shall be absolute and unconditional and shall not be affected by any circumstance, including, without limitation, any setoff, counterclaim, recoupment, defense or other right which the Company may have against Employee or anyone else. All amounts payable by the Company hereunder shall be paid without notice or demand. Employee shall not be required to mitigate the amount of any payment provided for in this Agreement by seeking other employment.

(e) The Company shall require any successor, whether direct or indirect, by purchase, merger, consolidation or otherwise, to all or substantially all of the business and/or assets of the Company, by written agreement to expressly assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no such succession had taken place.

(f) This Agreement shall inure to the benefit of and be enforceable by Employee's heirs, successors and assigns. If Employee should die while any amounts would still be payable to Employee hereunder if Employee had continued to live, all such amounts shall be paid in accordance with the terms of this Agreement to Employee's heirs, successors and assigns.

(g) For the purposes of this Agreement, notices and all other communications provided for in this Agreement shall be in writing and shall be deemed to have been duly given when delivered or mailed by United States registered mail, return receipt requested, postage prepaid, addressed as follows:

| If to Employee: | If to the Company: |
|---|---|
| Joseph B. Phair | Varian Medical Systems, Inc. |
| 242 Wawona Street | 3100 Hansen Way |
| San Francisco, CA 94127 | Palo Alto, CA 94304-1000 |
| | Attn: Vice President, Human Resources |

or to such other address as either party furnishes to the other in writing in accordance herewith, except that notices of change of address shall be effective only upon receipt.



(h) This Agreement shall constitute the entire agreement between Employee and the Company concerning the subject matter of this Agreement.

(i) The validity, interpretation, construction and performance of this Agreement shall be governed by the laws of the State of California without giving effect to the provisions, principles or policies thereof relating to choice or conflict of laws. The invalidity or unenforceability of any provision of this Agreement in any circumstance shall not affect the validity or enforceability of such provision in any other circumstance or the validity or enforceability of any other provision of this Agreement, and, except to the extent such provision is invalid or unenforceable, this Agreement shall remain in full force and effect. Any provision in this Agreement which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective only to the extent of such prohibition or unenforceability without invalidating or affecting the remaining provisions hereof in such jurisdiction, and any such

prohibition or unenforceability in any jurisdiction shall not invalidate or render unenforceable such provision in any other jurisdiction. This Section 60) shall survive any termination of this Agreement.

(j) This Agreement may be terminated by the Company pursuant to a resolution adopted by the Board at any time prior to a Potential Change in Control Date. After a Change in Control Date or a Potential Change in Control Date, this Agreement may only be terminated with the consent of Employee.

(k) No agreements or representations, oral or otherwise, express or implied, with respect to the subject matter hereof have been made by either party which are not expressly set forth in this Agreement and this Agreement shall supersede all prior agreements, negotiations, correspondence, undertakings and communications of the parties, oral or written, with respect to the subject matter hereof including, without limitation, the Change in Control Agreement between Employee and the Company dated November 1,1998.

(l) In the event that the Company becomes party to a transaction that is intended to qualify for "pooling of interests" accounting treatment and, but for one or more of the provisions of this Agreement would so qualify, then this Agreement shall be interpreted so as to preserve such accounting treatment, and to the extent that any provision of this Agreement would disqualify the transaction from pooling of interests accounting treatment, then such provision shall be null and void. All determinations to be made in connection with the preceding sentence shall be made by the independent accounting firm whose opinion with respect to "pooling of interests" treatment is required as a condition to the Company's consummation of such transaction.



IN WITNESS WHEREOF, the parties acknowledge that they have read and understand the terms of this Agreement and have executed this Agreement to be effective as of August 20, 1999.

| VARIAN MEDICAL SYSTEMS, INC. | EMPLOYEE |
|---|---|
| /s/ Richard M. Levy | /s/ Joseph B. Phair |
| By: Richard M. Levy | Joseph B. Phair |
| Title: President and Chief Executive Officer | |

EXHIBIT 10.13

# AMENDED AND RESTATED SEVERANCE AGREEMENT

THIS AMENDED AND RESTATED SEVERANCE AGREEMENT (Agreement) is entered into effective as of August 20, 1999 (superceding the Agreement dated November 20, 1998 as amended February 19, 1999), by and between Varian Medical Systems, Inc., a Delaware corporation (the Company), and Joseph Phair, an employee of the Company (Employee).

The Company's Board of Directors (the Board) has determined that it is in the best interest of the Company and its stockholders for the Company to engage in a reorganization (the "Triple Spin") pursuant to which the Company will be divided into three distinct entities with separate management (the "Post-Spin Companies"). The Board has further determined that the services of Employee will no longer be required after the consummation of the Triple Spin and believes that it is appropriate to reward the Employee for Employees previous service to the Company and to provide Employee with an incentive to remain in the employ of the Company pending the successful completion of the Triple Spin.

In view of the foregoing, the Company and Employee agree as follows:

1. RESIGNATION; OTHER TERMINATIONS.

(a) Upon the consummation of the Triple Spin or upon such earlier date as mutually agreed by the parties (the "Termination Date"), Employee shall resign as a director and/or officer of the Company and, on such future date selected by the Company's Chief Executive Officer, also resign as a director and/or officer of each of the Company's direct or indirect subsidiaries or affiliated companies with respect to which Employee held such a position on the Termination Date or thereafter, and will become an inactive employee of the Company (in which capacity Employee will not be expected to perform any regular work for the Company), and will remain an inactive employee for the period set forth in Section 3.(a)(iv), or upon conclusion of which employee shall, at Employee's election, either resign or retire from the Company. In addition, Employee shall resign as of the Termination Date as a member of each committee of the Companies on which he was then serving and as a director, officer, trustee or representative of any of the Companies. For purposes of this Agreement, the term "Companies" shall include the Company and each of its direct or indirect majority-owned subsidiaries.

(b) It is anticipated that Employee will remain in the employ of the Company and continue to perform Employee's regular duties until the Termination Date. If prior to the Termination Date Employee voluntarily terminates employment for any reason or Employee's employment is terminated by the Company for Cause, or in the event of the death, Disability or Retirement of Employee prior to the Termination Date, this Agreement shall lapse upon such termination of employment and be of no further force or effect. If the Company terminates the employment of Employee prior to the Termination Date without Cause, Employee shall be entitled to the payments and benefits provided herein and for purposes of determining such payments and benefits, the date of such termination shall be the Termination Date.

(c) If the Company terminates Employee's employment for Cause, the Company shall pay Employee's Base Salary through the date of termination at the rate in effect at the time notice of termination is given, and the Company shall have no further obligations to Employee under this Agreement.

(d) Any termination of employment by the Company or by Employee prior to the Termination Date as described in Section l(b) or (c) (other than death) shall be communicated by written notice, specify the date of termination, state the specific basis for termination and set forth in reasonable detail the facts and circumstances of the termination in order to provide a basis for determining the entitlement to any payments under this Agreement.

(e) If within thirty (30) days after notice of termination is given, the party to whom the notice was given notifies the other party that a Dispute exists, the parties will promptly pursue resolution of such Dispute with reasonable diligence; provided, however, that pending resolution of any such Dispute, the Company shall pay 75% of any amounts which would otherwise be due Employee pursuant to Section 3 if such Dispute did not exist into escrow pending resolution of such Dispute and pay 25% of such amounts to Employee. Employee agrees to return to the Company any such amounts to which it is ultimately

determined that he is not entitled.

2. DEFINITIONS

For purposes of this Agreement:

Base Salary shall mean the annual base salary paid to Employee immediately prior to the Termination Date, provided that such amount shall in no event be less than the annual base salary paid to Employee during the one (1) year period immediately prior to the Termination Date.

Cause shall mean:

(i) The continued willful failure of Employee to perform Employee's duties to the Company (other than any such failure resulting from Employee's incapacity due to physical or mental illness) after written notice



thereof (specifying the particulars thereof in reasonable detail) and a reasonable I opportunity to be heard and cure such failure are given to Employee by the Board or a committee thereof; or

(ii) The willful commission by Employee of a wrongful act that caused or was reasonably likely to cause substantial damage to the Company, or an act of fraud in the performance of Employee's duties on behalf of the Company; or

(iii) The conviction of Employee for commission of a felony in connection with the performance of Employee's duties on behalf of the Company; or

(iv) The order of a federal or state regulatory authority having jurisdiction over the Company or its operations or by a court of competent jurisdiction requiring the termination of Employees employment by the Company.

Disability shall mean Employee's incapacity due to physical or mental illness such that Employee shall have become qualified to receive benefits under the Company's long-term disability plan as in effect on the Termination Date.

Dispute shall mean a disagreement between Employee and the Company regarding the existence of Disability or Cause.

Retirement shall mean Employee's actual retirement after reaching the normal or early retirement date provided for in the Company's Retirement and Profit-Sharing Program as in effect on the date of Employee's termination of employment.

Severance Period shall mean the whole and partial number of years determined by multiplying (i) the Severance Factor by (ii) one (1) year.

3. PAYMENTS AND BENEFITS UPON RESIGNATION.

(a) Upon the resignation or Retirement of Employee on the Termination Date in accordance with Section 1(a) and Employee's satisfaction of the Release Delivery Requirement, Employee shall be entitled to the following payments and benefits:

(i) The Company shall pay to Employee as compensation for services rendered, no later than five (5) business days following Employee's satisfaction of the Release Delivery Requirement, a lump sum severance payment (the "Cash Severance") equal to 2.50 (the "Severance Factor") multiplied by the sum of (A) Employee's Base Salary and (B) the highest



annual bonus paid to Employee in any of the three years ending prior to the Termination Date under the Company's Management Incentive Plan (MIP).

(ii) The Company shall pay to Employee as compensation for services rendered, no later than five (5) business days following the date of termination, a lump sum payment equal to a pro rate portion (based on the number of days elapsed during the year in which the "Termination Date" occurs) of Employee's target bonus under the Company's Management Incentive Plan (MIP) for the year in which the "Termination Date" occurs.

(iii) All waiting periods for the exercise of any stock options

granted to Employee and all conditions or restrictions of any restricted stock granted to Employee shall terminate, and all such options shall be exercisable in full according to their terms, and the restricted stock shall be transferred to Employee as soon as reasonably practicable thereafter. In the event that Employee's combined age and service with the Company as of the Termination Date satisfy the definition of "Retirement", the resignations described in Section 1 hereof shall constitute "retirement" for purposes of the Company's Omnibus Stock Plan.

(iv) Employee's participation as of the Termination Date in the life, medical/dental/vision and disability insurance plans and financial/tax counseling plan of the Company shall be continued on the same terms (including any cost sharing) as if Employee were an employee of the Company (or equivalent benefits provided) until the earlier of Employee's commencement of substantially equivalent full-time employment with a new employer or twenty-four (24) months after the Termination Date; provided, however, that after the
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Termination Date, Employee shall no longer be entitled to receive Company-paid executive physicals or, upon expiration of the applicable memberships, Company-paid airline memberships. In the event Employee shall die before the expiration of the period during which the Company is required to continue Employee's participation in such insurance plans, the participation of Employee's surviving spouse and family in the Company's insurance plans shall continue throughout such period.

(v) Employee may elect upon the "Termination Date" to purchase any automobile then in the possession of Employee and subject to a lease of which the Company is the lessor by payment to the Company of the residual value set forth in the lease, without any increase for remaining lease payments during the term or other lease breakage costs. Employee may elect to have any such payment deducted from any payments due Employee hereunder.

(vi) Each of Employees outstanding awards under the Long Term Incentive feature of the Company's Omnibus Stock Plan (the LTIP)



shall, within five (5) days of Employee's satisfaction of the Release Delivery I Requirement, be settled as follows:

(A) for the 1997 to 1999 and the 1998 to 2000 LTIP cycles, an amount equal to each such award's target payout shall be paid; and

(B) for the 1999 to 2001 LTIP cycle, an amount equal to a pro rate portion (based on the number of days elapsed during such award cycle as of the "Termination Date") of such award's target payout shall be paid.

All LTIP awards settled on an accelerated basis shall not be discounted to take into account such early settlement.

(vii) All payments and benefits provided under this Agreement shall be subject to applicable tax withholding.

(b) Following Employee's termination of employment for any reason, the Company shall have the unconditional right to reduce any payments owed to Employee hereunder by the amount of any due and unpaid principal and interest on any loans by the Company to Employee and Employee hereby agrees and consents to such right on the part of the Company.

4. RELEASE.
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In recognition of the consideration recited above, Employee hereby agrees to execute a release effective as of the Termination Date in favor of the Company in substantially the form attached hereto as Exhibit A and Employee acknowledges that no payments are required to be made by the Company hereunder until Employee satisfies the Release Delivery Requirement. For purposes of the Agreement, "Release Delivery Requirement" shall mean (i) the delivery of the
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release on the Termination Date in substantially the form attached hereto as Exhibit A and (ii) the expiration of the seven-day period commencing on the date of such delivery without the Executive having revoked the release.

5. GENERAL.
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(a) Employee shall retain in confidence under the conditions of the Company's confidentiality agreement with Employee any proprietary or other confidential information known to him concerning the Company and its business so long as such information is not publicly disclosed and disclosure is not required by an order of any governmental body or court. If required, Employee shall return to the Company any memoranda, documents or other materials proprietary to the Company.

(b) While employed by the Company and following the termination of such employment (other than a termination of employment by the Company other than for Cause) for a period of two (2) years, Employee shall not, whether for Employee's own account or for the account of any other individual, partnership, firm, corporation or other business organization, intentionally Solicit, endeavor to entice away from the Company, any Post-Spin Company or a subsidiary of any of them (each, a Protected Party) or otherwise interfere with the
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relationship of a Protected Party with, any person who is employed by a Protected Party or any person or entity who is, or was within the then most recent twelve (12) month period, a customer or client of a Protected Party.

Employee acknowledges that a breach of the covenant contained in this Section 5(b) may result in material irreparable injury to the Company for which there may be no adequate remedy at law, that it may not be possible to measure damages for such injuries precisely and that, in the event of such a breach, any payments remaining under the terms of this Agreement shall cease and the Company may be entitled to obtain a temporary restraining order and/or a preliminary or permanent injunction restraining Employee from engaging in activities prohibited by this Section 5(b) or such other relief as may be required to specifically enforce any of the covenants in this Section 5(b). Employee agrees to and hereby does submit to in personam jurisdiction before each and every such court in the
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State of California, County of Santa Clara, for that purpose. This Section 5(b) shall survive any termination of this Agreement.

(c) If litigation is brought by Employee to enforce or interpret any provision contained in this Agreement, the Company shall indemnify Employee for Employee's reasonable attorneys fees and disbursements incurred in such litigation and pay prejudgment interest on any money judgment obtained by Employee calculated at the prime rate of interest in effect from time to time at the Bank of America, San Francisco, from the date that payment should have been made under the Agreement, provided that Employee shall not have been found by the court in which such litigation is pending to have had no cause in bringing the action, or to have acted in bad faith, which finding must be final with the time to appeal therefrom having expired and no appeal having been taken.

(d) Except as provided in Section 3, the Company's obligation to pay to Employee the compensation and to make the arrangements provided in this Agreement shall be absolute and unconditional and shall not be affected by any circumstance, including, without limitation, any setoff, counterclaim, recoupment, defense or other right which the Company may have against Employee or anyone else. All amounts payable by the Company hereunder shall be paid without notice or demand. Employee shall not be required to mitigate the amount of any payment provided for in this Agreement by seeking other employment.



(e) This Agreement shall inure to the benefit of and be enforceable by (i) Employee's heirs, successors and assigns and (ii) the Post-Spin Companies. If Employee should die while any amounts would still be payable to Employee hereunder if Employee had continued to live, all such amounts shall be paid in accordance with the terms of this Agreement to Employee's heirs, successors and assigns.

(f) For the purposes of this Agreement, notices and all other communications provided for in this Agreement shall be in writing and shall be deemed to have been duly given when delivered or mailed by United States registered mail, return receipt requested, postage prepaid, addressed as follows:

| If to Employee: | If to the Company |
|---|---|
| Joseph Phair | Varian Associates, Inc. |
| 242 Wawona Street | 3100 Hansen Way |
| San Francisco, CA 94127 | Palo Alto, CA 94303-1000 |
| | Att: Vice President, Human Resources |

or to such other address as either party furnishes to the other in writing in accordance herewith, except that notices of change of address shall be effective only upon receipt.

(g) This Agreement shall constitute the entire agreement between Employee and the Company concerning the subject matter of this Agreement.

(h) The validity, interpretation, construction and performance of this Agreement shall be governed by the laws of the State of California without giving effect to the provisions, principles or policies thereof relating to choice or conflict of laws. The invalidity or unenforceability of any provision of this Agreement in any circumstance shall not affect the validity or enforceability of such provision in any other circumstance or the validity or enforceability of any other provision of this Agreement, and, except to the extent such provision is invalid or unenforceable, this Agreement shall remain in full force and effect. Any provision in this Agreement which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective only to the extent of such prohibition or unenforceability without invalidating

or affecting the remaining provisions hereof in such jurisdiction, and any such prohibition or unenforceability in any jurisdiction shall not invalidate or render unenforceable such provision in any other jurisdiction. This Section 5(h) shall survive any termination of this Agreement.



(i) No agreements or representations, oral or otherwise, express or implied, with respect to the subject matter hereof have been made by either party which are not expressly set forth in this Agreement and this Agreement shall supersede all prior agreements, negotiations, correspondence, undertakings and communications of the parties, oral or written, with respect to the subject matter hereof.

IN WITNESS WHEREOF, the parties acknowledge that they have read and understand the terms of this Agreement and have executed this Agreement to be effective as of August 20, 1999.

| VARIAN ASSOCIATES, INC. | EMPLOYEE |
|---|---|
| /s/ Richard M. Levy | /s/ Joseph B. Phair |
| By: Richard M. Levy | Joseph B. Phair |
| Title: President and Chief Executive Officer | |

EXHIBIT 10.14

# VARIAN MEDICAL SYSTEMS, INC.
# SUPPLEMENTAL RETIREMENT PLAN

## SECTION 1
## BACKGROUND, PURPOSE AND DURATION

1.1 Effective Date. The Plan is effective as of October 1, 1999.

1.2 Purpose of the Plan. The purpose of the Plan is to provide deferred compensation consisting of allocations of Matching Contributions and Profit-Sharing Contributions that exceed the amounts that the Dollar Limitations permit to be allocated under the Retirement Plan, but that are otherwise calculated by reference to the Retirement Plan.

## SECTION 2
## DEFINITIONS

The following words and phrases shall have the following meanings unless a different meaning is plainly required by the context:

2.1 "Code" means the Internal Revenue Code of 1986, as amended. Reference to a specific section of the Code or regulation thereunder shall include such section or regulation, any valid regulation promulgated thereunder, and any comparable provision of any future legislation or regulation amending, supplementing or superseding such section or regulation.

2.2 "Committee" means the Organization and Compensation Committee of the Company's Board of Directors.

2.3 "Company" means Varian Medical Systems, Inc., a Delaware corporation, or any successor thereto.

2.4 "Compensation Ceiling" means the limitation described in section 401(a)(17) of the Code, adjusted as prescribed by the Code. The Compensation Ceiling for plan years beginning in 1999 is $160,000.



2.5 "Dollar Limitations" means (a) the Compensation Ceiling and (b) the limitation on annual additions described in section 415(c)(1) of the Code, adjusted in each case as prescribed by the Code.

2.6 "Eligible Earnings" shall have the meaning given to such term in the Retirement Plan, except that Eligible Earnings for purposes of this Plan shall not be subject to the Compensation Ceiling.

2.7 "ERISA" means the Employee Retirement Income Security Act of 1974, as amended. Reference to a specific section of ERISA shall include such section, any valid regulation promulgated thereunder, and any comparable provision of any future legislation amending, supplementing or superseding such section.

2.8 "Participant" means an individual who is eligible to participate in the Plan pursuant to Section 3 and for whose benefit an amount is credited to a Reserve Account pursuant to Section 3.

2.9 "Plan" means the Varian Medical Systems, Inc. Supplemental Retirement Plan, as set forth in this instrument and as hereafter amended from time to time.

2.10 "Plan Year" means the Retirement Plan's Plan Year.

2.11 "Reserve Account" means the unfunded bookkeeping account described in Section 3.2.

2.12 "Retirement Plan" means the Varian Medical Systems, Inc. Retirement Plan, as amended from time to time.

2.13 "Unforeseeable Emergency" means a severe financial hardship to the Participant resulting from a sudden and unexpected illness or accident of the Eligible Participant or of a dependent of the Participant, from a loss of the Participant's property due to casualty or from other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the Participant. A hardship shall not constitute an Unforeseeable Emergency under the Plan to the extent that it is or may be relieved:

(a) Through reimbursement or compensation, by insurance or otherwise;

(b) By liquidation of the Participant's assets, to the extent that the liquidation of such assets would not itself cause severe financial hardship; or



(c) By discontinuing deferrals under this Plan or under any other plan of the Company as soon as permissible.

An Unforeseeable Emergency under the Plan shall in no event include the need to send a child to college or the desire to purchase a home.

2.14 "Valuation Date" means the last day of each calendar quarter.

Any capitalized terms used in the Plan and not defined herein shall have the meaning provided in the Retirement Plan.

## SECTION 3
## ELIGIBILITY, PARTICIPATION, RESERVE ACCOUNTS AND CREDITS

3.1 Participation in the Plan shall be limited to:

(a) Officers of the Company (not including any officer holding the office of only Assistant Secretary or Assistant Treasurer) who are active Retirement Plan participants; and

(b) Participants in the Retirement Plan whose Eligible Earnings under the Retirement Plan are limited by the Compensation Ceiling.

The Company, in its sole discretion, may determine that one or more individuals qualify as Participants for the Plan Year pursuant to Subsection (b) based upon such individual's compensation for the prior year or current salary rate and target bonus compensation (to the extent includible in Eligible Earnings). Any such determination shall be valid for the Plan Year, regardless of whether the individual's Eligible Earnings at the end of the Plan Year actually exceed the Compensation Ceiling.

3.2 Reserve Account. The Company shall establish on its books a special unfunded Reserve Account for each Participant. As of each Valuation Date, the Company shall credit interest on the balance in each Reserve Account (not including any amounts credited under Sections 3.3 and 3.4 below during the calendar quarter then ending). The interest credited to the Reserve Account shall be established from time to time by the Committee.

3.3 Matching Contributions. As of each Valuation Date in a Plan Year following the date when the Participant's contributions to the Retirement Plan reach



the limitation in effect under Code section 402(g) (which limitation is $10,000 for 1999), the Company shall credit to a Participant's Reserve Account an amount determined as follows:

(a) First, the hypothetical amount of the Participant's Matching Contribution since the preceding Valuation Date shall be calculated, based on the assumptions (i) that the Dollar Limitations do not apply and (ii) that the Participant's contributed to the Retirement Plan at a rate of 6% of Eligible Earnings;

(b) Second, the amount calculated under Subsection (a) above shall be reduced (but not below zero) by the actual amount of the Participant's Matching Contribution since the preceding Valuation Date; and

(c) The remainder (if any) shall be the amount credited to the Participant's Reserve Account under this Section 3.3.

3.4 Profit-Sharing Contributions. As of the Valuation Date coinciding with or next following the date (if any) when the Company makes a Profit-Sharing Contribution under the Retirement Plan, the Company shall credit to a

Participant's Reserve Account an amount determined as follows:

(a) First, the hypothetical amount of the Participant's share of the Profit-Sharing Contribution shall be calculated, based on the assumption that the Dollar Limitations do not apply;

(b) Second, the amount calculated under Subsection (a) above shall be reduced (but not below zero) by the actual amount of the Participant's share of the Profit-Sharing Contribution; and

(c) The remainder (if any) shall be the amount credited to the Participant's Reserve Account under this Section 3.4.

## SECTION 4
## DISTRIBUTIONS

4.1 Right to Receive Payment. Any amount that may become payable under the Plan shall be paid solely from the general assets of the Company. Nothing in this Plan shall be construed to create a trust or to establish or evidence any Participant's claim of any right other than as an unsecured creditor with respect to any payment to which he or she may be entitled.



4.2 Timing of Payment---In General. Following the termination of a Participant's employment with the Company and its subsidiaries, the Company shall pay to the Participant the balance credited to his or her Reserve Account in 10 annual cash installments.

4.3 Accelerated Payment in Case of Emergency. In the event of a Participant's Unforeseeable Emergency, upon application by the Participant, the Committee may determine in its sole discretion that (a) distribution of all or a portion of the Participant's Reserve Account shall be made on a date prior to the Participant's termination of employment or (b) all or a portion of one or more annual cash installments being paid to a Participant who has terminated employment shall be accelerated. Distributions on account of an Unforeseeable Emergency shall be permitted only to the extent reasonably needed to satisfy the Participant's need.

4.4 Distribution With Penalty. Upon application by a Participant, the Committee may determine in its sole discretion that distribution of all or a portion of the Participant's Reserve Account shall be made prior to the Participant's termination of employment (even in the absence of an Unforseeable Emergency). Similarly, upon application by a Participant who has terminated employment and is receiving cash installments, the Committee may determine in its sole discretion that all or a portion of one or more of such annual cash installments shall be accelerated. All distributions under this Section 4.4 shall be reduced by a penalty equal to six percent of the amount otherwise distributable, which penalty shall be forfeited to the Company.

4.5 Payment in the Event of Death. In the event of a Participant's death before the entire Reserve Account has been distributed to him or her, the unpaid balance remaining in the Participant's Reserve Account shall be paid to his or her beneficiary or beneficiaries under the Retirement Plan, at such time(s) and in such form as the Committee shall determine in its sole discretion.

## SECTION 5
## ADMINISTRATION

5.1 Committee is the Administrator. The Plan shall be administered by the Committee.

5.2 Committee Authority. It shall be the duty of the Committee to administer the Plan in accordance with the Plan's provisions. The Committee shall have all powers and discretion necessary or appropriate to administer the Plan and to



control its operation including, but not limited to, the power to (a) determine which Retirement Plan participants shall be eligible to participate in this Plan, (b) determine the amounts to be credited to Reserve Accounts, (c) determine whether to grant applications for accelerated payments pursuant to Sections 4.3 and 4.4, (d) determine distributions to be made in the event of death pursuant to Section 4.5, (e) interpret the Plan, (f) adopt such rules for the administration, interpretation and application of the Plan as are consistent therewith and (g) interpret, amend or revoke any such rules.

5.3 Decisions Binding. All determinations and decisions made by the

Committee, the Board and any delegate of the Committee pursuant to the provisions of the Plan shall be final, conclusive and binding on all persons, and shall be given the maximum deference permitted by law.

5.4 Delegation by the Committee. The Committee, in its sole discretion and on such terms and conditions as it may provide, may delegate all or part of its authority and powers under the Plan to one or more directors, officers or employees of the Company.

## SECTION 6
## CLAIMS AND REVIEW PROCEDURES

6.1 Application for Benefits. Any application for benefits under the Plan shall be submitted to the Committee at the Company's principal office. Such application shall be in writing and on the prescribed form, if any, and shall be signed by the applicant.

6.2 Denial of Applications. In the event that any application for benefits is denied in whole or in part, the Committee shall notify the applicant in writing of the right to a review of the denial. Such written notice shall set forth, in a manner calculated to be understood by the applicant, specific reasons for the denial, specific references to the Plan provisions on which the denial was based, a description of any information or material necessary to perfect the application, an explanation of why such material is necessary, and an explanation of the Plan's review procedure. Such written notice shall be given to the applicant within 90 days after the Committee receives the application, unless special circumstances require an extension of time for processing the application. In no event shall such an extension exceed a period of 90 days from the end of the initial 90-day period. If such an extension is required, written notice thereof shall be furnished to the applicant before the end of the initial 90-day period. Such notice shall indicate the special circumstances requiring an extension of time and the date by which the Committee expects to render a decision.



If written notice is not given to the applicant within the period prescribed by this Section 6.2, the application shall be deemed to have been denied for purposes of Section 6.3 upon the expiration of such period.

6.3 Request for Review. Any person whose application for benefits is denied in whole or in part (or such person's duly authorized representative) may appeal the denial by submitting to the Committee a request for a review of such application within 90 days after receiving written notice of denial. The Committee shall give the applicant or such representative an opportunity to review pertinent documents (except legally privileged materials) in preparing such request for review and to submit issues and comments in writing. The request for review shall be in writing and shall be addressed to the Committee at the Company's principal office. The request for review shall set forth all of the ground on which it is based, all facts in support of the request, and any other matters which the applicant deems pertinent. The Committee may require the applicant to submit such additional facts, documents, or other material as it may deem necessary or appropriate in making its review.

6.4 Decision on Review. The Committee shall act upon each request for review within 60 days after receipt thereof, unless special circumstances require an extension of time for processing, but in no event shall the decision on review be rendered more that 120 days after the Committee receives the request for review. If such an extension is required, written notice thereof shall be furnished to the applicant before the end of the initial 60-day period. The Committee shall give prompt, written notice of its decision to the applicant and to the Company. In the event that the Committee confirms the denial of the application for benefits in whole or in part, such notice shall set forth, in a manner calculated to be understood by the applicant, the specific reasons for such denial and specific references to the Plan provisions on which the decision is based. To the extent that the Committee overrules the denial of the application for benefits, such benefits shall be paid to the applicant.

6.5 Exhaustion of Administrative Remedies. No legal or equitable action for benefits under the Plan shall be brought unless and until the claimant (a) has submitted a written application for benefits in accordance with Section 6.1, (b) has been notified that the application is denied, (c) has filed a written request for a review of the application in accordance with Section 6.3, and (d) has been notified in writing that the Committee has affirmed the denial of the application; provided, however, that an action may be brought after the Committee has failed to act on the claim within the time prescribed in Section 6.2 and Section 6.4, respectively.

## SECTION 7
## GENERAL PROVISIONS

7.1 Tax Withholding. The Company shall withhold all applicable taxes from any payment under this Plan, including any federal, state and local taxes (including the Participant's FICA obligation).

7.2 No Effect on Employment or Service. Nothing in the Plan shall interfere with or limit in any way the right of the Company to terminate any Participant's employment or service at any time, with or without cause. Employment with the Company and its affiliates is on an at-will basis only. The Company expressly reserves the right, which may be exercised at any time, to terminate any individual's employment with or without cause, and to treat him or her without regard to the effect that such treatment might have upon him or her as a Participant.

7.3 Participation. No individual shall have the right to be selected to participate in the Plan for any particular Plan Year.

7.4 Indemnification. To the extent permitted by ERISA, each person who is or shall have been a member of the Committee, or of the Board, shall be indemnified and held harmless by the Company against and from (a) any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by him or her in connection with or resulting from any claim, action, suit, or proceeding to which he or she may be a party or in which he or she may be involved by reason of any action taken or failure to act under the Plan and (b) from any and all amounts paid by him or her in settlement thereof, with the Company's approval, or paid by him or her in satisfaction of any judgment in any such claim, action, suit, or proceeding against him or her, provided he or she shall give the Company an opportunity, at its own expense, to handle and defend the same before he or she undertakes to handle and defend it on his or her own behalf. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such persons may be entitled under the Company's Certificate of Incorporation or Bylaws, by contract, as a matter of law, or otherwise, or under any power that the Company may have to indemnify them or hold them harmless.

7.5 Successors. All obligations of the Company under the Plan shall be binding on any successor to the Company, whether the existence of such successor is the result of a direct or indirect purchase, merger, consolidation, or otherwise, of all or substantially all of the business or assets of the Company.

7.6 Nontransferability of Awards. No portion of any Participant's Reserve Account may be sold, transferred, pledged, assigned, or otherwise alienated or



hypothecated, and any act in violation of this Section shall be void. All rights with respect to a Participant's Reserve Account shall be available during his or her lifetime only to the Participant.

## SECTION 8
## AMENDMENT, TERMINATION AND DURATION

8.1 Amendment, Suspension or Termination. The Company, in its sole discretion, may amend or terminate the Plan, or any part thereof, at any time and for any reason. . The Company shall also have the authority to distribute all or a portion of any Participant's Reserve Account at any time, regardless of whether the Plan is then being terminated. The amendment, suspension or termination of the Plan shall not, without the consent of the Participant, alter or impair any rights or obligations under the Plan.

8.2 Duration of the Plan. The Plan shall commence on the date specified herein and, subject to Section 8.1 (regarding the Company's right to amend or terminate the Plan), shall remain in effect thereafter.

## SECTION 9
## LEGAL CONSTRUCTION

9.1 Gender and Number. Except where otherwise indicated by the context, any masculine term used herein also shall include the feminine; the plural shall include the singular and the singular shall include the plural.

9.2 Severability. In the event any provision of the Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not affect the remaining parts of the Plan, and the Plan shall be construed and enforced as if the illegal or invalid provision had not been included.

9.3 Requirements of Law. Benefits provided under the Plan shall be subject to all applicable laws, rules and regulations, and to such approvals by any governmental agencies as may be required.

9.4 Governing Law. The Plan shall be construed in accordance with governed by ERISA and, to the extent not preempted by ERISA, by the laws of the State of California, but without regard to its conflict of law provisions.

9.5 Captions. Captions are provided herein for convenience only, and shall not serve as a basis for interpretation or construction of the Plan.

EXECUTION

IN WITNESS WHEREOF, Varian Medical Systems, Inc. by its duly authorized officer, has executed the Plan on the date indicated below.

VARIAN MEDICAL SYSTEMS, INC.

Dated: 10/1/99

By: /s/ Joe Phair

Name: Joe Phair
Title: Vice President, Adminstration, General Counsel and Secretary

EXHIBIT 10.15

Description of Compensatory Arrangements with Directors

Amended and Restated Description of Compensatory arrangements between Registrant and its Directors incorporated by reference to the section entitled "Management - Compensation of Directors" in Registrant's form 8K, current report, dated March 8, 1999, Exhibit 99.

EXHIBIT 10.16

Description of Certain Compensatory Arrangements between Registrant and Executive Officers

Registrant's Executive Car Program

The Registrant's officers are eligible to participate in the Executive Car Program which includes lease reimbursement, insurance, personal use of the vehicle, operating expenses and reimbursement for taxes related to the Registrant's Executive Car Program.

Registrant's Executive Financial Counseling Program

The Registrant reimburses its officers as follows for the costs they incur for financial counseling, tax planning and tax return preparation, subject to a $6,500 annual limit. The Registrant has made available (for an annual retainer fee) a financial counseling firm to provide such services to the Registrant's officers.

Registrant's Executive Health Program

The Registrant's officers are eligible to participate in the Executive Health Program, under which those officers are reimbursed for the costs of an annual medical examination, subject to a $700 annual limit.

EXHIBIT 21

LIST OF SUBSIDIARIES

The following table sets forth certain information concerning the principal subsidiaries of the Company.

| Name | State or Other Jurisdiction of Incorporation |
|---|---|
| Varian Associates Limited | USA, CA |
| Varian Realty, Inc. | USA, CA |
| Varian BioSynergy, Inc. | USA, DE |
| Varian UK Ltd. | USA, DE |
| Varian Medical Systems Latin America, Ltd. | USA, DE |
| Varian Oncology Systems China, Ltd. | USA, DE |
| Varian Medical Systems India Pvt. Ltd. | USA, DE |
| Varian Medical Systems Pacific, Inc. | USA, DE |
| Varian Medical Systems Canada, Inc. | USA, DE |
| Healthcare Technologies International, L.L.C. | USA, DE |
| Page Mill Corporation | USA, MA |
| Mansfield Insurance Company | USA, VT |
| Varian Medical Systems Australasia Pty Ltd. | Australia |
| Varian Medical Systems Gesellschaft m.b.H. | Austria |
| Varian Medical Systems Belgium N.V. | Belgium |
| Varian Medical Systems Brazil Limitada | Brazil |
| Varian Oncology Services Scandinavia AS | Denmark |
| Varian Oncology Services Finland OY | Finland |
| Varian Medical France S.A.S. | France |
| Varian Oncology Services Generale, SARL | France |
| Varian Medical Systems Deutschland G.m.b.H. | Germany |
| Varian Medical Systems Italia S.p.A. | Italy |
| Varian Medical Systems K.K. | Japan & Delaware |
| Nippon Oncology Systems, Ltd. | Japan |
| Varian FSC B.V. | Netherlands |
| Varian Medical Systems Nederland B.V. | Netherlands |
| Varian Medical Systems Iberica S.L. | Spain |
| Varian Medical Systems International A.G. | Switzerland |
| Varian TVT Limited | United Kingdom |
| Varian Medical Systems UK Ltd. | United Kingdom |
| Varian Philippines, Ltd. | USA, DE |
| Varian Medical Systems New Zealand (not active) | USA, DE |

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EXHIBIT 23

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statement on Form S-8 (No. 333-75531) of Varian Medical Systems, Inc. (formally Varian Associates, Inc.) of our reports dated November 4, 1999 relating to the financial statements and financial statement schedule, which appear in this Form 10-K.

/s/ PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP

San Jose, California
December 22, 1999

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