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Varian Medical Systems, Inc. (VAR)

Q4 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, greetings and welcome to the Varian Medical Systems, Inc. Fourth Quarter Fiscal Year 2018 Earnings Results Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this program is being recorded.

It is now my pleasure to introduce your host, Michael Bruff. Thank you. You may begin.

J. Michael Bruff

Senior Vice President-Investor Relations Corporate Planning & Segment Finance, Varian Medical Systems, Inc.

Thank you, operator. Good afternoon, everyone. Joining me today on the call are Varian's President and Chief Executive Officer, Dow Wilson; and Chief Financial Officer, Gary Bischooping. Dow will share his thoughts on our results and long-term strategy, and Gary will cover our operating and financial results in more detail.

On the Varian Investor Relations website, you can find our fiscal fourth quarter press release and web deck, which are intended to provide additional perspective and details. A webcast of this call and any accompanying non-GAAP reconciliations are available on our website at www.varian.com/investors. Unless otherwise stated, all financial results discussed are non-GAAP and from continuing operations. All references to EPS are to net earnings per diluted share. All growth rates are year-over-year and any references to orders are gross orders. All periods referred to are fiscal periods unless otherwise stated.

During this call, we will be making forward-looking statements which are predictions, projections, or other statements about future events. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially because of factors discussed in today's earnings release, this conference call, and our SEC filings. We do not undertake any duty to update any forward-looking statements.

And with all that said, I'll turn it over to Dow.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

Thanks, Mike, and good afternoon, everyone. Today I'll share the key milestones we achieved this past quarter and year and how they contributed to our long term-strategy as well as provide our outlook for the upcoming fiscal year. First, let me touch on our fiscal fourth quarter performance which was the result of strong execution both from a growth and operational perspective. Total revenues of \$802 million, increased 11%. Oncology revenues grew 13%, driven by our integrated platform with best-in-class hardware, software, and services. Revenues for our Proton Solutions business were \$46 million.

On a full year basis, total revenues were \$2.9 billion, a growth of 11%, operating earnings of \$142 million or 17.8% of revenues, grew 14%. For the full year operating earnings of \$517 million or 17.7% of revenues, grew 31%. GAAP EPS of \$1.26, grew 49%; and non-GAAP EPS of \$1.16, grew 11%.

For the full year, GAAP EPS of \$1.62 declined 33% due to the one-time impact of the Tax Cuts and Jobs Act and non-GAAP EPS of \$4.42, grew 36%. Cash flow from operations were \$108 million, down 17%. For the full year, cash flows from operations were \$455 million, up 14%.

The U.S./China tariffs impacted our Q4 result which Gary will discuss in more detail in his section. The situation continues to be dynamic, but Varian remains committed to ensuring that our customers and the patients they treat are able to achieve new victories against cancer without any disruption in access to our leading-edge technologies.

Our long-term growth strategy is working. We believe it is the right focus and that we have the capabilities to grow our leadership position. We continue to leverage our scale and financial strength to selectively broaden our portfolio as we transform our company into a global leader in multidisciplinary integrated cancer care solutions.

In pursuit of this strategy, we recently announced changes in our leadership team. In May, we established the Oncology Software Solutions group under Corey Zankowski who is bringing together and aligning our global software team and strategy.

In October, we are pleased to announce that Kolleen Kennedy will serve as Chief Growth Officer as well as lead the FlashForward initiative and our Proton Solutions business. Chris Toth is succeeding Kolleen as the new President of Varian's Oncology Systems business. Kolleen, Chris and Corey have made tremendous contributions to Varian over the last two decades and we are confident that this team will provide the right leadership to deliver on our growth strategy.

So now let me spend some time on the solid progress we have made across our three growth initiatives. First, strengthening our leadership in radiation therapy. Based on public filings, the radiation therapy market grew 8% on an orders basis over the trailing 12 months ending in June 2018. We maintained our market leadership and worldwide share during that period.

In our Oncology business, orders grew 13% in the quarter to a record \$1.1 billion. The first time we've broken \$1 billion in orders for a quarter. For the full year we grew orders 9% to a record \$3.1 billion. Similarly, this was the first time we exceeded \$3 billion in annual orders.

Adding to these impressive milestones, growth in both the fourth quarter and full-year were driven by growth in every region. This success has been driven by investments in field infrastructure and industry leading innovation. This past year big competitive wins included McLaren, Karolinska, and now GenesisCare.

Our worldwide net linac installed base is now 8,057 units, growing 224 units in the fiscal year. Each net new socket represents meaningful future revenue from software, services, upgrades, and most importantly more patient lives touched.

On the hardware side we made progress with our global rollout of Halcyon and have taken – and have now taken 182 orders since our May 2017 launch including 84 in the fourth quarter. Nearly 40% of these orders were for greenfield sites demonstrating Halcyon's ability to expand the market. The uptick was driven by several factors. First, ongoing marketing efforts and customer endorsements have been a strong driver for new orders as early adopters have had an excellent experience treating all disease sites. Second, this was the first full quarter in which we had 510(k) clearance for Halcyon with kilovoltage cone-beam CT imaging and the second full quarter with clearance for this offering in EMEA.

Kilovoltage imaging provides a more advanced solution for the mature market segment and nearly 40% of the orders in the fourth quarter were for the kV Halcyon option.

Finally, the public tender process takes some time and we're starting to see tender wins with Halcyon. Since launch over half our orders worldwide have been incremental, thus growing our installed base. In August, we extended our oncology portfolio with the acquisition of humediQ, the manufacturer of IDENTIFY, a surface-guided radiation therapy positioning and motion management system. IDENTIFY has unique patient safety tools such as biometric scanner to confirm the right patient will get the right treatment every time. By 2023, we see this market as \$120 million opportunity.

We had several exciting introductions at ASTRO this week. First, we shared details of our development work for our multi-modality adaptive radiotherapy suite that's driven by artificial intelligence. This platform brings MR, PET and CT imaging together at the console to enhance clinical decision making without compromise to high-fidelity radiation therapy delivery.

Second, we launched Bravos brachytherapy afterloader system, which is an integrated system designed to improve the patient and clinical experience by simplifying brachytherapy treatment and providing greater workflow efficiency. Bravos is a big step forward for brachytherapy treatments and we are excited to advance clinical efficiencies in this space.

On the software front, we continue to see strong demand and positive feedback for our software solutions. Software revenues grew 7% and the number of unique Varian software customers grew 5% to approximately 5,000. Customers continue to adopt Varian's software because of the value they derive from our fully integrated innovative cancer care solutions.

RapidPlan, our knowledge-based planning software had a second consecutive record quarter since launch and we took over 250 orders. The unique patented machining learning capabilities of RapidPlan have increased

quality and decreased [ph] dose symmetry time (00:09:17) for hundreds of thousands of patients. RapidPlan has now penetrated a little more than 15% of our Eclipse installed base. We still have plenty of runway for increased adoption by our Eclipse users.

HyperArc, our high-definition radiotherapy solution for stereotactic radiosurgery also had a record quarter with 65 orders. Since launch in Q4 last year, we have taken a total of approximately 170 orders. Finally, Eclipse MCO, providing multi-criteria optimization for enhanced control over treatment planning, had an exceptional quarter across all geographies with over 250 orders in the quarter. This represents a total of nearly 600 orders since launch in Q4 last year.

The customer uptake and demand for our best-in-class software products results from our focus on evolving market needs and emphasis on efficient clinical workflow, systems integration and treatment planning quality.

Services grew 11% for the quarter and 10% for the full-year, driven by our growing installed base and higher mix of newer, more advanced machines which typically have a higher attach rate and contract value. The strength of our service offerings was also validated in IMV's ServiceTrak Imaging 2018 report, in which we ranked first in the industry in Net Promoter Score. This score represents the likelihood a customer would recommend the manufacturer to a colleague and we're honored to lead this metric with a score of 71% as compared with an industry average of 53%.

In our Proton Solutions business, we did not take any new orders in the quarter. For the full-year we took two proton orders both in the first quarter. In the fourth quarter, we completed clinical handovers for one room each at three sites representing an important future recurring revenue stream for our Proton business. These clinical handovers took place at Georgia Proton Treatment Center, Danish Center for Particle Therapy and the Christie Proton Beam Therapy Center.

In September, we announced the installation of the cyclotron for the single room proton therapy system at Delray Medical Center in Florida. Varian is partnering with Proton International for the installation and the first patient treatments are expected to start in the fall of 2019.

At ASTRO, this week, we also announced exciting new developments. First, we announced the formation of the FlashForward Consortium to study potentially groundbreaking ultra-high dose rate cancer treatments with protons which is more commonly known as Flash.

This research effort will build upon encouraging preclinical and translational studies that suggest Flash protects healthy tissue while maintaining excellent tumor control thereby enhancing therapeutic ratio. We look forward to working closely with the initial 13 innovative members of this Consortium to take an important step forward in cancer research.

Second, we introduced ProBeam 360, our new single-room proton therapy system with a 30% smaller footprint and a 25% lower vault construction costs as compared with the previous system. This increases access to this technology and provides clinicians with a viable path to potential next generation treatments such as Flash therapy. With the launch of ProBeam 360 and under Collins' leadership, we expect renewed growth in the Proton business over the long term. So, lot of exciting developments that are strengthening our leadership in radiation therapy.

Our second growth initiative is to extend our global footprint. For context, our sales mix for the full year was approximately 50% in the Americas, 30% in EMEA and 20% in APAC. Our growth was driven by strong performance across all geographies.

The largest growth was driven by our Asia Pacific region which saw a number of key wins in the quarter. We signed a Memorandum of Understanding with GenesisCare to form a strategic partnership for cancer care research and increased the access to advanced care – cancer care in Australia and Europe. This resulted in orders for 10 linacs in Australia in the fourth quarter.

We also continued to execute well in China and Japan with double-digit growth and market leadership. In EMEA, we saw our fifth straight quarter of double-digit orders growth driven by tender wins in Spain and Scandinavia, strong software growth and outstanding Halcyon orders of over 40 units.

We also saw robust performance from upgrades of over [ph] \$85 million (00:13:44), an increase of 30% for the quarter and 44% for the full year. Upgrades include linear accelerator enhancements like HyperArc and our 6-degree of freedom couch and were driven by EMEA, by the hiring of a dedicated upgrade team to focus where the needs were greatest.

We continue to extend our global footprint by winning large tenders providing integrated best-in-class products and solutions for both mature and emerging markets and by winning competitive takeouts. On the Halcyon front, global momentum continues to grow. Of the Halcyon orders taken since our mid-2017 launch, over 40% have been from emerging markets and over 80% of those have been for incremental units.

One of our key ambitions for Halcyon is to expand access to high-quality radiation therapy to under-served regions around the world. We have continued to see progress in Africa where Varian recently signed a partnership agreement with Mediheal Group of Hospitals to expand access to radiotherapy in Kenya. This relationship includes the supply of one TrueBeam and four Halcyon systems to five new radiation therapy centers across the country, as well as service, training and research collaboration opportunities.

We also recently announced the first patient treatment in India on a Halcyon system at Sterling Cancer Hospital in Gujarat. Within one month, the hospital began comfortably treating 131 patients per day with the Halcyon system. We feel very good about the progress we're making globally, but there still is tremendous runway.

Finally, our third growth initiative is to expand into other addressable markets. We continue to believe that our comprehensive 360 Oncology software platform will be a driver of future growth for the company as we enter cancer care coordination, a market of large unmet need. We recently strengthened the capabilities of 360 Oncology with the acquisition of Noona Healthcare, a developer of cloud-based mobile patient engagement software designed to capture cancer patient-reported outcomes or PROs. Patient-reported outcomes are growing in importance for evidence-based clinical trials and translational research. With this acquisition, Varian gains new partnerships with life-science companies as the Noona software application is used to engage patients, collect PRO data, manage patient communications and enable clinical studies that will test the efficacy of treatment modalities.

Overall, we're pleased with the progress we made in the fourth quarter and full year and the meaningful strides taken towards achieving our long-term strategy to become a global leader in multi-disciplinary integrated cancer care solutions.

With that, I'll turn it over to Gary who will provide more context on the fourth quarter and full-year financial results.

Gary Bischooping, Jr.

Senior Vice President, Finance & Chief Finance Officer, Varian Medical Systems, Inc.

Thanks, Dow, and hello, everyone. As always, I will consistently frame my comments in the context of our long-term growth and value creation strategy which includes balancing growth, profitability and liquidity. So let me start with growth, companywide revenues were \$802 million in the fourth quarter, up 11% or 12% in constant currency.

Oncology revenues in the quarter were impacted by approximately \$4 million of contra revenue from the China retaliatory tariffs enacted August 23, which are not accounted for in our previous guidance. For the full year, revenues of \$2.9 billion were up 11% or 10% in constant currency. We ended the year with \$3.2 billion in backlog, up 3%.

In Oncology, revenues were \$756 million, up 13% or 14% in constant currency, driven by growth across hardware, software and services. For the full year, revenues grew 14% or 12% in constant currency. Orders were \$1.1 billion, up 13% or 14% in constant currency. For the full year, orders grew 9% or 8% in constant currency. We ended the quarter with \$3 billion in backlog, up 7%.

Taking a closer look at our oncology business results, in the Americas, revenues grew 6% in the quarter and 8% for the full year. Orders of \$506 million grew 6%, driven by 4% growth in North America and strong double-digit growth in Latin America. For the full year, orders in the Americas grew 5% and orders in North America grew 3%. Growth in North America was driven by numerous large multi-site orders and healthy demand for our SRS and SBRT solutions.

In Europe, Middle East, India, and Africa geography revenues grew 27% in the quarter and 28% for the full year. Orders were \$361 million, increasing 14%, for the full year, orders grew 17%. We have seen outstanding results across the region with five consecutive quarters of double digit growth, driven by tender wins and strong performance across the geography.

Asia Pacific revenues grew 9% in the quarter and 10% for the full year. Orders were \$200 million for the first time, increasing 31% due to remarkable execution by the commercial teams in China and Japan, key account wins in Australia, and growth from this year's acquisition of our distributor in Taiwan. For the full year, orders for the Asia Pacific region grew 9%.

We saw mid-teens growth in Greater China in the quarter with low double-digit growth for the year and we continue to lead the market there. In Japan, orders grew over 50% contributing to full year growth of nearly 20%. Our Proton Solutions business posted revenues of \$46 million in the quarter, which is down 12% compared with last year. For the full year, revenues were \$149 million, down 18%.

Turning to profitability, total company fourth quarter gross margin increased 11%, driven by our Oncology business where we continue to see solid revenue growth across the portfolio. The gross margin rate was 42.5% of revenues, relatively flat year-over-year. This included the impact of tariffs to our Oncology business which resulted in approximately 30 basis points of negative impact at the total company level. For the full year, gross margin rate increased 114 basis points to 43.9%.

Oncology fourth quarter gross margin increased 9%, largely driven by revenue growth and the rate was 43.9%, down 141 basis points. Approximately 30 basis points of this decline was driven by tariffs impact referenced above and the rest from geographic mix that was more heavily weighted outside North America as compared with last year. Full year Oncology gross margin increased by 22 basis points to 45.5%.

Looking at Proton Solutions, fourth quarter gross margin dollars were \$9 million, up \$5 million. Full year gross margin dollars were up 27% driven by progress on high margin projects – on higher margin projects.

Now let me turn to our key investment areas. We remain committed to investing in our business to drive value over the long term. In the quarter, R&D investments of \$60 million was up 15% at 7.4% of revenues, R&D expenses for the full year were \$234 million, up 11% and representing 8% of revenues. R&D spend this year was driven by investments in software, adaptive radiotherapy and other strategic innovation programs.

In the quarter, SG&A expenses were \$138 million or 17.3% of revenues, down 71 basis points as a percent of revenues, driven by productivity improvements in the G&A functions. For the full year, SG&A expenses were \$529 million or 18.1% of revenues, down 149 basis points as a percent of revenues. The decrease was primarily driven by the non-recurrence of a \$38 million accounts receivable reserve related to the Proton business last year. Excluding this item, SG&A spend was flat for the full year, driven by continued investments in sales and marketing that were offset by G&A efficiencies.

Company operating earnings were \$143 million or 17.8% of revenues increasing 14%. For the full year, operating earnings of \$517 million or 17.7% of revenues increased 31%. For the full year and for each quarter of fiscal year 2018, we have driven leverage in the P&L by growing operating earnings faster than revenue.

In the fourth quarter, we recognized \$6 million in incremental interest income from the realization of accrued interest on the Maryland Proton Treatment Center loan paid upon refinancing of the center in August.

Turning to taxes, for the full year, our GAAP effective tax rate was 66.8% due to the one-time impact of the U.S. Tax Cuts and Jobs Act. The IRS has not issued final tax regulations associated with the recent U.S. tax legislation. The impacts of the Act reflected in our results and our projection of future tax rates represent our best estimates of the impact of the Act and could change as tax regulations are finalized and the laws further interpreted and applied to our facts.

For the full year, our non-GAAP effective tax rate was 22.4%. This was higher than the 21% we expected primarily because of a shift in the geographic mix of earnings. GAAP EPS was \$1.26 and non-GAAP EPS was \$1.16 with related diluted share count of 92.2 million shares in the quarter. For the full year, GAAP EPS was \$1.62 and non-GAAP EPS was \$4.42, up 36%. An external factor that impacted our EPS was a \$0.03 negative impact due to the August 23 enactment of China retaliatory tariffs which are introduced after we set guidance.

Turning to the balance sheet and liquidity, we ended the year with cash and cash equivalents of \$505 million and zero debt. While cash flow from operations were \$108 million down 17%, the full year cash flow from operations were \$455 million, up 14%. This fell short of expectations driven by faster growth in Europe resulting in higher receivables balance. Even with the increase in AR, Oncology DSO decreased by 9 days from 111 to 102 days further demonstrating improved operational discipline and working capital management.

In addition to R&D, other investments in the quarter included \$17 million in CapEx. We were active in buying back shares this quarter spending \$50 million on share repurchases. As of the end of the year, we had 3.6 million shares remaining under our existing repurchase authorization.

I will now turn it back to Dow who will discuss our fiscal year 2019 annual guidance.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

Thanks, Gary. With respect to our annual guidance, we continue to maintain a pragmatic approach and have considered the following assumptions regarding our fiscal year 2019 guidance. First, continued projected market growth. Second, our products and solutions are resonating driving our market leadership. And third, we've reflected the projected impact of the tariffs imposed on July 6, by the United States Trade Representative, as well as the impact of the China retaliatory tariffs imposed on August 23.

Included in this guidance is the net impact from tariffs of \$18 million to operating earnings, down from a gross impact of \$60 million. We are implementing specific actions within our supply chain and commercial operations while driving productivity in G&A and re-phasing some R&D investments. In aggregate, these actions will address 70% of the impact from tariffs.

After careful consideration of these assumptions, we expect the following for fiscal year 2019. Revenue of \$3.06 billion to \$3.15 billion, representing growth of 5% to 8%. Non-GAAP operating earnings as a percentage of revenues of 17% to 18%. Non-GAAP earnings per share of \$4.60 to \$4.75. Cash flows from operations of \$460 million to \$510 million. The guidance assumes a non-GAAP effective tax rate of 21% to 22% and a weighted average diluted share count of 92 million.

The guidance also assumes foreign exchange rates as of the beginning of fiscal year 2019 excludes any future M&A activity, and includes the expected impact of all currently enacted tariffs. As it will take several months to phase in our various mitigation efforts around tariffs, we expect our earnings performance to be more heavily weighted toward the back half of the year.

Thank you. And now let's go to Q&A. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Amit Hazan from Citigroup. You are now live.

Amit Hazan

Analyst, Citigroup Global Markets, Inc.

Q

[indiscernible] (00:28:20), guys. Nice numbers. I thought maybe I would start with Halcyon just because it was obviously such a big change just from 90 days ago and from what we've seen really since the launch. I think I get what you're saying by some of the drivers but I'm just hoping you could give us a little bit more color on the – just given the magnitude of the change this quarter versus prior quarters and what really was behind driving this. I mean, is this what we – kind of, is this really kV that's been driving this or what else did you see in the quarter that really helped you with Halcyon getting to these much larger numbers?

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

I think, a couple of things. First of all, we love the volume. I think that's something that we've been seeing in our funnel all along ever since we introduced it. The kilovoltage clearance, the 510(k) clearly had an impact in the U.S. market as well the kilovoltage introduction at ASTRO earlier this year to go out and get that funnel going. Well, you heard the numbers, we had very good uptake in Europe on that product as well.

So the kilovoltage product along with some of the adaptive radiation therapy vision that we're talking about on the product is really triggering the developed market. But I'd say the other thing that we really like about this is, one thing that's been consistent from the launch is 40% of these are incremental new sockets. So we really like that fact. We – very strong in emerging markets, 60% mature, 40% emerging markets on the year. So that's good, 40% new sites. So it's growing our installed base, I think that's a really – kind of to underscore that 40% of the Halcyon orders we took in 2018 were for greenfield sites.

These are folks new in the business, very excited about that. We also saw fair amount of competitive takeouts. And I mean we've been talking a little bit, we've had the question on the tender market. We've been a little bit hesitant on that that we wanted to be from Missouri and when we saw it, you got it. And I think that has been building some demand. And we also saw some very good tender wins on the product.

Amit Hazan

Analyst, Citigroup Global Markets, Inc.

Q

Okay. And just a follow up on the tariffs, in both China and the U.S. Just wanted to get a sense from you is – whether it's during the quarter or what you expect for the next fiscal year on the top line? Did you see any impact from the tariffs on the top line in terms of customer reactions, if any and do you expect any for fiscal 2019? Thanks.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

The short version is, you saw our fourth quarter. I alluded to our fourth quarter performance in China. We had a double-digit quarter in China. So certainly on the quarter, didn't see any impact. In fact, it was good enough that we've had some delay in maybe Q2, Q3. We've made very strong statements to that market about our strategy

there. We want to continue to be the market leader. We believe our share is growing in that market and we have a clear demonstrated market leadership, great relationships, great technology. And so we're very pleased by what we saw in Q4 in China. And from at least a market point of view, we're clearly watching it, but at this point in time we are okay. Maybe Gary can talk little bit about the revenue side of it as it translates from a tariff point of view.

Gary Bischooping, Jr.

Senior Vice President, Finance & Chief Finance Officer, Varian Medical Systems, Inc.

A

Yeah, I mean, just to kind of tease this out a little bit more to be transparent about it, so of the \$60 million of gross impact, \$48 million of that is related to the retaliatory tariff from China. And so that's our products going from the U.S. into China. And that will be treated as contra revenue. \$12 million of the \$60 million of gross impact will be treated as costs and that's related to our products that are coming from China to the U.S.

And so that's kind of the accounting and mechanics as to what the gross impact is for FY 2019. And again now, through the operating actions we talked about, right, in terms of supply chain, commercial operations, G&A, productivity, and our R&D re-phasing, we can net that back down to an \$18 million impact in FY 2019.

Amit Hazan

Analyst, Citigroup Global Markets, Inc.

Q

Just one final quick one for you, Gary, can you give us your guidance, your revenue guidance for the year ex-FX?

Gary Bischooping, Jr.

Senior Vice President, Finance & Chief Finance Officer, Varian Medical Systems, Inc.

A

Revenue guidance is 5% to 8%, and that's inclusive of all the tariffs that are enacted today.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

The FX.

Amit Hazan

Analyst, Citigroup Global Markets, Inc.

Q

[indiscernible] (00:33:07).

Gary Bischooping, Jr.

Senior Vice President, Finance & Chief Finance Officer, Varian Medical Systems, Inc.

A

FX, sorry.

Amit Hazan

Analyst, Citigroup Global Markets, Inc.

Q

Yeah.

Gary Bischooping, Jr.

Senior Vice President, Finance & Chief Finance Officer, Varian Medical Systems, Inc.

A

Sorry, misheard you. So on the FX side, it's the FX rates at the start of our fiscal year.

Amit Hazan

Analyst, Citigroup Global Markets, Inc.

Q

And what would the growth be in constant currency for fiscal 2019, if it's 5% to 8% reported, what would it be constant currency?

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

There is some impact to it, Amit. We don't know based on – at current rates, it's not all that terribly material, we think, for 2019. But again, it's already impacted or already accounted for in 5% to 8% growth we talked about.

Amit Hazan

Analyst, Citigroup Global Markets, Inc.

Q

Okay. Thanks. I'll jump back in the line – in the queue. Thanks, guys.

Operator: Thank you. Our next question comes from the line of Anthony Petrone from Jefferies. You're now live.

Anthony Petrone

Analyst, Jefferies LLC

Q

Thanks and congratulations on the strong fourth quarter. Maybe to start again on Halcyon, just the order flow this quarter, just kind of wondering when you look at prior product cycles, TrueBeam, for instance, I think that product cycle, maybe back seven years or so, peaked at maybe 350, 375 orders for the year. I mean, based on this run rate, we would sort of be getting close to 300, north of 300 for the year. So how long in the runway do you think Halcyon is from a product cycle and where you think it could peak on in terms of adding all the orders? And then, I have a follow-up on guidance. Thanks.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

There's a couple of differences here. When we introduced TrueBeam, we were eventually replacing our whole product line. That is not the case here. Halcyon is very complementary focused to our product line. We want to keep both growing. We love the quarter. As I said, we have huge uptake in incremental sockets, growing the installed base. That's really been the focus. So having both of these products in our product basket is just a market-leading position. [ph] It can't be beat (00:35:08).

In terms of kind of where does it go, we're very interested to watch what happens in developed markets. The product has had a very good reception in development markets. The kilovoltage introduction is new. Here at ASTRO, sorry if my voice was a little gravelly, I've been talking a lot the last five days. But the adaptive strategy with Halcyon is going to give us some more legs in the developed market.

And then in emerging markets, I mean even with this big uptick that we saw in Q4, we still had 40% of – the actual percentage that was growing in emerging markets. It's exactly what we've seen over the rest of the year. So, I think in a very good position.

I just – kind of stepping back a little bit from – today is the last day of the ASTRO exhibit here. We've got the strongest portfolio we've ever had. And you kind of look across hardware, software, proton therapy, vision for the future, capture the imagination of our customers, I couldn't be prouder of the team and what we've done at this year's ASTRO.

Anthony Petrone

Analyst, Jefferies LLC

Q

That's helpful. And then the follow-up on guidance would be, I guess by my math, that's about a \$0.16 impact to earnings from tariffs. But I know there's a variable there in share count. So I'm just wondering if that's accurate. And my understanding was that there was various exemptions, pathways offered to companies both in the U.S. and in China actually. And so is there a potential for some of those exemptions to go through and EPS headwind to reverse? Thanks.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

[indiscernible] (00:36:58) why don't you talk about guidance and I'll talk a little about [indiscernible] (00:37:02).

Gary Bischooping, Jr.

Senior Vice President, Finance & Chief Finance Officer, Varian Medical Systems, Inc.

A

Yeah, sure. Anthony, you're pretty much spot on, \$0.15, \$0.16 is spot on to the impact. So good math there.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

Yeah. And then in terms of what's the likelihood of getting an exemption, we continue to have encouraging and productive conversations with key government leaders to ensure that we can bring our cancer solutions to patients around the world. And especially in China, we're actively – we've filed an exemption to exclude us from the current trade dispute. We won't know until that – it's kind of the binary thing yes or no. In the meantime, we're monitoring the situation very, very closely.

Anthony Petrone

Analyst, Jefferies LLC

Q

Thanks.

Operator: Thank you. Our next question comes from the line of Tycho Peterson from JPMorgan. You are now live. Tycho, you are now live. Perhaps your line might be on mute.

Q

Hello. This is [ph] Zeleni (00:38:05) on for Tycho. We were wondering, can you guys remind us what adjacencies you're leaning towards in terms of your M&A strategy heading into your next fiscal year? Is it still a string of pearls approach?

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

Sure. I think you saw what we did in 2018. In 2018, we had acquisitions that were both complementary to our core business and some acquisitions that were smaller that took us out of the core business. We did have run at Sirtex as you know, a little bigger. We're willing to do bigger acquisitions provided we see good return on invested capital, return on the investment we make in the acquisition and synergies with our portfolio.

I would say, the key areas that we'll look at are complementing our software business. You saw one of those from us 10 days ago. We acquired Noona Health (sic) [Noona Healthcare] (00:39:00). Noona Health (sic) [Noona Healthcare] (00:39:01), I mentioned briefly in the call, it's patient-reported outcomes software, cloud-based tool that looks very, very exciting. We're very pleased that it also gives us a little bit of a play in the pharma space. So we're taking patient-reported outcomes in cancer, across the cancer enterprise, so to speak, to evaluate how clinical trials are performing and what the patient perceives as outcome. And we're very excited about that opportunity. As we look at our treatment planning business, we see that there's an opportunity to extend treatment planning into other forms of doing radiation. And that's a nice play for us, whether it'd be radioembolization. We started some of those opportunities organically. There may be some inorganic ones. We continue to look at interventional oncology as a potential play and there might be some really good synergies in other places where radiation is used as a tool for cancer care.

Q

Great. And a question on the tariff front, we were wondering what are some of the steps you have taken to offset the tariff impact on your margins?

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

Yeah. Gary, you want to take a crack at that one?

Gary Bischooping, Jr.

Senior Vice President, Finance & Chief Finance Officer, Varian Medical Systems, Inc.

A

Yeah. Like we outlined here, kind of looking at this holistically and what are the opportunities there. And we see opportunities in the supply chain. We're taking actions around our commercial operations today making sure that G&A productivity holds up in this environment. And looking and evaluating the R&D portfolio and re-phasing some of that. That R&D portfolio re-phasing, will not impact kind of long-term things that we announced today at ASTRO and other things that are strategic innovation programs in the portfolio but those are the major actions.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

Yeah. I think the only thing I'd add to that is, we said it in the call, but it's going to take us couple of quarters to get some of this going. And so, the impact will be a little bit second half weighted.

Q

Great. Thank you.

Operator: Thank you. Our next question comes from the line of Vijay Kumar from Evercore ISI. You are now live. Vijay, your line is now live, perhaps you might be on mute.

Vijay Kumar

Analyst, Evercore Group LLC

Q

Hey, guys. This is Vijay. Thanks for taking my question. So maybe just one starting on with – and I apologize if this has been asked, but I wanted to get back on the Halcyon orders. Maybe you can comment on – like what

drove this trend type? Is this now at an inflection point, [ph] right, I guess (00:41:54), we're trying to understand what was one-off. Was the bulk order or how sustainable is this?

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

In the short version it's 1,000 points of light here. It's – we had very good marketing effort over the last year since the launch. Customer endorsements have been very strong. I haven't – I didn't say it in the call but our uptime on the product has been 99%. And forget uptime for a second, what that really speaks to is the robustness of this product from its first day.

And you're looking at other products that competitors are bringing to market they fumble and stumble for four or five years and finally they get the workflow right and introduce and the product kind of finally works. This has been an outstanding product from the beginning.

Yeah, there might be a little seasonality because Q4 is our biggest quarter of the fiscal year, so I'd expect some seasonality from that point of view. We did. It was the first full quarter where we had the 510(k) clearance, second full quarter with the clearance for the kilovoltage imaging in EMEA.

I think – we're here at ASTRO, we launched our adaptive strategy that will be linked to the Halcyon product. I think there is – yeah, there's going to be some seasonality and there's going to be lumpy quarters and down quarters and up quarters. But I think there's very good momentum on this product.

Vijay Kumar

Analyst, Evercore Group LLC

Q

That's helpful, Dow. And just maybe on the guidance here. I know in the past you've spoken about being in talks with the administration on maybe getting an exemption on the tariff impacts. So can you give us an update on where you are relative to vis-à-vis talks with the administration?

And then, when I look at the revenues 5% to 8%, we just had a phenomenal year, right, for you guys from an organic revenue standpoint. Why would those trends moderate, if you will? And I understand the issue of tougher comps, but then it looks like the underlying business, just given the Halcyon orders you are picking up steam, so maybe can you comment on the revenue side as well?

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

For the tariff thing, first. As I said, we have filed an exemption. It's totally a binary process. We're having productive conversations with everybody involved, but it is a binary process. It's kind of yes/no. And so we don't really have news until we get a decision and there is kind of no guarantee on the timing. So we're pressing it very, very hard.

We think this is related – we're a big export – big net exporter in the U.S. It's 50,000-plus jobs in the U.S. that are involved. We treat almost all of the [ph] Veterans Administration (00:44:53) cancer patients who need radiation and it's very tied to our innovation story. So those are the arguments that we're making with the administration. And as soon as we hear, we'll let you know.

On the revenue side, Gary, why don't you comment and I'll make a little comment on the market after.

Gary Bischooping, Jr.

Senior Vice President, Finance & Chief Finance Officer, Varian Medical Systems, Inc.

A

Yeah, Vijay. So kind of the equation that goes into that 5% to 8% is we OS orders of 9% on the year. Our backlog has grown 7% NOS on the year. You think about it as I outlined in detail, there is \$48 million of contra revenue running in from the tariffs in that 5% to 8%. And so when you all – when you kind of put that all together that tells you that that 5% to 8% seems like it's about right when you tie up that equation.

Vijay Kumar

Analyst, Evercore Group LLC

Q

Maybe if I could squeeze one more in guys. Can you comment on the first half versus second half EPS cadence? And Gary, free cash flow, I know that the guidance at the midpoint for free cash. That implies a mid-single digit step up over fiscal 2018. But then it looks like fiscal 2018 came in below original expectations, right. So if this was a timing issue maybe can you just talk about when those free cash and maybe if there is a catch up coming down the road?

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

[indiscernible] (00:46:22) here. As you know we've switched to annual guidance, so we are annual guidance only. As I said in the preamble, we are second half weighted. A lot of the tariff mitigation strategies we're putting in place, we're putting in place over the course of the first half. So they'll impact our second half so our earnings will be a little more second half weighted, and Gary, you can take the rest of the question.

Gary Bischooping, Jr.

Senior Vice President, Finance & Chief Finance Officer, Varian Medical Systems, Inc.

A

Yeah, I think that's right, Dow. And I missed the rest of the question. Sorry.

Vijay Kumar

Analyst, Evercore Group LLC

Q

I'm sorry. On the free cash flow guidance.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

Did that gets you what you needed, Vijay?

Vijay Kumar

Analyst, Evercore Group LLC

Q

The free cash guidance. Sorry. So it looks like the fiscal 2018 came in below [indiscernible] (00:46:59). Yeah.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

[indiscernible] (00:46:59) little short, Vijay, and that's really driven by the strong earnings growth in Europe. And if you look at Europe kind of terms and conditions and they're just a little bit longer than the rest of the world. So just mix and that takes a little bit while to clear through. So, we like the guidance of \$460 million to \$510 million and we'll continue to evaluate that and drive operating actions to continue to move working capital in the right direction.

Vijay Kumar

Analyst, Evercore Group LLC



Thanks and congrats on a nice Halcyon order [ph] for you (00:47:28) guys.

Operator: Thank you. Our next question comes from the line of Brandon Henry from RBC Capital Markets. Your line is now live.

Brandon Henry

Analyst, RBC Capital Markets LLC



Yeah, thanks for taking my question. Just one question on the market growth, obviously, both you guys and Alecta talked about a pickup in market growth over the last couple of quarters. Can you just talk about what you think is driving that pickup in your view? And then what's giving you the confidence that this level of market growth can continue over the next 12 months? And just have a few follow-ups.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.



Well, I think, there's a couple of things going on. We finished the year, the U.S. – to look in the rearview mirror for a second, our U.S. numbers, we were up 6% in U.S., 5% constant currency. In EMEA, we were up 17%, 13% in constant currency, and then APAC, we were up 9% on the year, up 8% in constant currency.

So when you kind of think about that in the context of the markets, I'd say, the exceptional one here has been EMEA and EMEA has been across the board. Some of it is emerging markets. So we've got Africa and India and Eastern Europe in those numbers, Russia in those numbers, Middle East. I think that's going to continue.

We've had very good performance in Western Europe as well, Central and Western Europe. So that's been good. I'd say, we think that market's hanging in there. It's probably not a double-digit market, but it's hanging in there and the rest continues to grow very, very well. The other growth numbers in Asia and Americas, Americas is maybe a little better than we've done historically. Asia, arguably, we've done better.

So when I kind of look at the balance, I think, the markets are going to be up a little bit from what we've kind of historically talked about. We've kind of historically talked about a [ph] 2 to 4 (00:49:39) number and it's probably more mid-single digit kind of market scenario with some upside.

And we will say this, we feel very good about our portfolio. And one of the things that we're seeing is we think that portfolio might – that the upside in the market scenario might be upgrades and finally getting people to close out, to change out 12 to 15 year-old products to upgrade. And we'll watch that and report on it as we execute the year.

Brandon Henry

Analyst, RBC Capital Markets LLC



All right. And then on Halcyon, do you think there's any pent up demand for the Halcyon kV imaging in the developed markets? And how should we be thinking about the sustainability of that kind of gross order number over the next couple of quarters? And then maybe longer term, how do we think about the portfolio in terms of Halcyon, how you position that versus TrueBeam kind of longer term?

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.



The two products both have a great position in the marketplace. We are very excited about the adaptive strategy that we've launched on Halcyon. TrueBeam will remain our SBRT, SRS platform of choice, most flexible, fastest gun in the West. We have now done 1.5 million SRS and SBRT treatments over time. We still have a huge Clinac installed base to upgrade. Customers are making those choices one by one. Halcyon does not have electrons. TrueBeam has much higher dose rate, has much more flexible mechanical positions with the C-arm geometry and has the ultimate versatility in the market for doing all applications. We're beginning our adaptive strategy on Halcyon, but we'll extend the adaptive strategy across our entire business.

Our focus is on growing our installed base. That's why we started disclosing that to you about a year ago. You've seen the tremendous uptick, 220-ish unit installed base growth, the net installed base growth that we've had this last year. And that's kind of the way we are managing the portfolio as we sell it into the market. I do think the kilovoltage introduction in the developed world is material and exciting and that linked with the adaptive strategy on that product is going to give us some significant legs going forward.

Brandon Henry

Analyst, RBC Capital Markets LLC

Q

All right. Maybe just one last question for me, can you talk about the factor that get you to the upper and lower end of your fiscal year 2019 operating margin guidance range? And then what are you assuming in guidance for operating margin and EPS for FX? Thanks.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

Yeah. So, as it relates to the operating guidance of 17% to 18%, the way to think about that is there's about a 50 basis point impact in there from the tariffs that we had talked about. That [ph] \$18 million (00:52:58) net in operating earnings is at 50 basis points impact. And I think there's puts and takes to think your way through. I think the favorable things going on right now are certainly, so we're getting some operating leverage in G&A that we just talked about. We've got our software and services portfolio growing at great rates and those as you know are accretive to the company average margin rate.

And then, I would say, [ph] it's offsetting (00:53:23) and always balanced like I said, balancing growth and profitability over time with the investments we're making in R&D. If you look at what we rolled out today in the last couple of days here in San Antonio, that's a tremendous portfolio of R&D and that's yielding that kind of growth you're seeing in the top line. And so we want to make sure we continue to make those investments to continue that top line growth. So those are kind of the puts and takes as you think about operating earnings and that 17% to 18%.

As it relates to currency, again, the currency rates as of the end of our fiscal – the start of our fiscal year is what we have running in our guidance. And if you look at the kind of that what's implied – what's that implies is a small impact from currency on a year-over-year basis but not all that material.

Brandon Henry

Analyst, RBC Capital Markets LLC

Q

Okay. Thank you.

Operator: Thank you. Our next question comes from the line of Jason Bednar from Baird. Your line is now live.

Jason M. Bednar

Analyst, Robert W. Baird & Co., Inc.

Q

Thanks guys. Just wanted to start on China first, some of the macro data and recent public company commentary out of – I've got some recent report suggests that there is some rumblings of maybe an economic slowdown. Obviously, you guys are still putting up some very good numbers, but just curious if you've seen any of that on the ground or any change in willingness to spend from customers in that market?

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

A

Not at all. The China market remains very under-served from a radiation therapy point of view. Our funnel remains very, very good. We're working through this U.S.-China trade dispute. It's very important to us but that would be resolved from lots of reasons but from a market point of view, at least so far, we're seeing a robust market environment as the government continues to invest in cancer services.

I'd say, from a relative share position, we have continued to grow our share in that market, over many, many years, we've extended our share. We have market leading position. When you look at the China public tender wins, we have done very, very well and grown share in each of the last two quarters in that market as well. One of the things that we're seeing in that market is we're seeing demand beyond hardware. So we're very excited about that. We've got some local localization strategies for our software and we're seeing some uptick in the software business as well there which is relatively new for us.

Jason M. Bednar

Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Thanks, Dow. And then just curious Dow or Gary, can you provide any more detail on what the tariff mitigation efforts really consist of, I know you mentioned alternating some sourcing or some things in the supply chain but just trying to get a sense of the risk profile around what some of those risk mitigation efforts are and if you have pretty good line of sight to truly mitigating that 70% of that impact.

Gary Bischooping, Jr.

Senior Vice President, Finance & Chief Finance Officer, Varian Medical Systems, Inc.

A

Taken some swift actions there in the supply chain and in commercial operations. They are going to be second half oriented in order for us to get those into place. Competitively and given everything that's going on, we're not going to talk a lot more detail about what the actions are that we're taking right now. But we are very transparent right about the \$48 million and the \$12 million breakout and the impact on a gross level. And look, we're going to go execute just like we executed in FY 2018 and the right operational rigor in order to deliver on our commitments. So that's what we know and as when – and when we know more about the tariffs we'll share more.

Jason M. Bednar

Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Thanks, Gary. And then just one last quick one if I could sneak it in, just on [ph] Augmedics (00:57:16), I believe you had a minority interest in that business before it was recently acquired. Is that something that's reflected in guidance or is that just a one-off that you'll exclude?

Gary Bischooping, Jr.

Senior Vice President, Finance & Chief Finance Officer, Varian Medical Systems, Inc.

A

It's a one off. We owned a very small percentage of that company and it'll be below the line.

Jason M. Bednar

Analyst, Robert W. Baird & Co., Inc.

Okay. Last...

Q

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

[indiscernible] (00:57:34) in guidance.

A

Gary Bischooping, Jr.

Senior Vice President, Finance & Chief Finance Officer, Varian Medical Systems, Inc.

Yeah. And not reflected in guidance at all.

A

Operator: Thank you. Our next question comes from the line of Isaac Ro from Goldman Sachs. You're now live.

Frits Jonker

Analyst, Goldman Sachs & Co. LLC

Hey, guys, this is Frits on for Isaac. Two questions from me, first one on gross margin. I know you've talked about some supply chain shuffling and that software is a healthy mix. But we just appreciate getting a feel for what's assumed in your guidance for gross margin next year and kind of the puts and takes there.

Q

And then second question on the tax rate, obviously it was higher than expected this quarter. Part of that was geographic mix. And then again next year guiding above was expected for this year. Just wondering given the growth rates that were seen in your business higher out of the United States, why is it going up in those situations? Thanks.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

Yeah. I'll take the last one first on the tax rate. From a tax rate perspective, I would say, it was geographic mix mostly driven by hedging contracts, not really as much as the underlying business. Those hedging contracts realize value in the U.S. and so you get a higher tax on that, and the underlying exposure to outside the U.S. which you can't deduct. And so that's the majority of that geographic mix in earnings. It's not really the underlying business.

A

The second part – the first part of your question again one more time, sorry?

Frits Jonker

Analyst, Goldman Sachs & Co. LLC

In gross margin, I know software is a positive benefit. You are working to mitigate supply chain costs from tariffs. Just overall puts and takes there and what you're assuming for guidance next year. Thanks.

Q

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

Guide to the gross margin rate. I would say that, just puts and takes wise, certainly continuing the mix of that software and services business is favorable. I would tell you that the tremendous momentum we've seen in Halcyon will then also start to roll into the P&L here into FY 2019.

A

It's a little bit offset by geographic mix. The more you mix outside the U.S., you get a little bit of pressure inside the margin, gross margin line. But overall, I think the teams are executing very well in market to sell value and to realize the right price tradeoffs with growth. And so, very pleased with the team's performance this past year and no reason to believe why that wouldn't continue.

Frits Jonker

Analyst, Goldman Sachs & Co. LLC

Got it. Thanks very much.

Q

Operator: Thank you. Ladies and gentlemen, our next question comes from the line of Anthony Petrone from Jefferies. Your line is now live.

Anthony Petrone

Analyst, Jefferies LLC

Thanks for the call. Maybe just in the 5% to 8% guidance, there was a handful of acquisitions and so, I'm just wondering what the contribution from various software transactions are in that 5% to 8% guidance. And then, overall just capital allocation, you mentioned tuck-ins. There's other areas, of course, you can move in but you'll also did some buybacks this quarter. So I haven't seen you come to the market in a bit, so just wondering what's reflected in earnings guidance for buybacks. Thanks.

Q

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

Anthony, and on the M&A front, it's really kind of immaterial next year. I think a lot of what we've invested in has tremendous legs in the portfolio and will yield great benefit to us over time. And the key tuck-ins both in the core as well as in the software business we're expecting nice results from but on track relative to our business cases but nothing really terribly material in FY 2019.

From a capital allocation perspective, I would say that you saw us a little more active in the market here in the fourth quarter buying back about \$50 million worth of stock versus we are averaging \$25 million to \$30 million or so prior to that.

We'll continue to manage to roughly a flat share count as we've included this assumption inside of that earnings per share guidance. And we'll kind of see how this plays out and go from there but no material change in the capital allocation approach going forward. We want to make sure we maintain enough financial flexibility to take advantage of opportunities we see out there organically. And we think we're lined up nicely right now to do that.

Anthony Petrone

Analyst, Jefferies LLC

Thanks.

Q

Operator: Thank you. Ladies and gentlemen, we have no further questions in queue at this time. I'd like to turn the floor back over to management for closing.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

Looking for the close here. Wait, we got it right here. Thank you. In closing, just a few comments, one, the strength of our business is such that we continue to compete effectively worldwide and whether the U.S. China tariff situation.

As we said, the gross impact of tariffs could be \$60 million and we expect to mitigate that down to \$8 million next year. The strength of our China business is outstanding. We had a double-digit growth rate in fourth quarter building on several years of market share growth.

Gary Bischooping, Jr.

Senior Vice President, Finance & Chief Finance Officer, Varian Medical Systems, Inc.

Sorry, just to interrupt just really quickly, mitigate down to \$18 million.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

What did I say?

Gary Bischooping, Jr.

Senior Vice President, Finance & Chief Finance Officer, Varian Medical Systems, Inc.

You said \$8 million.

Dow R. Wilson

President, Chief Executive Officer & Director, Varian Medical Systems, Inc.

\$8 million, sorry. From \$60 million to \$18 million. The strength of our China business is outstanding, we had a double-digit growth rate in the fourth quarter building on several years of market share growth and we remain committed to customers and maintaining our growth in China. We look forward to having Halcyon in our product basket here soon.

In closing, we have excellent momentum fueled by our investments in innovation and commercial infrastructure over the last few years and we continue to win in the marketplace and we have absolutely no intention of pulling back now.

Thank you for joining us today. I'm very pleased with the progress we've made in the fourth quarter and over the last year towards executing on our long-term value creation strategy and in everything we do we remain committed to innovating new technologies to drive towards the ultimate victory, a world without the fear of cancer.

Thanks for joining us today.

Operator: Thank you, ladies and gentlemen. This does conclude our teleconference for today. You may now disconnect your line at this time. Thank you for participation and have a wonderful day.

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