

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

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

For the quarterly period ended December 29, 2017
or

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

For the transition period from _____ to _____
Commission File Number 001-37860



VAREX IMAGING CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

**1678 S. Pioneer Road,
Salt Lake City, Utah**

(Address of principal executive offices)

81-3434516

(I.R.S. Employer
Identification Number)

84104

(Zip Code)

(801) 972-5000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large Accelerated filer

☐

Accelerated filer

☐

Non-Accelerated filer

☒

Smaller reporting company

☐

Emerging growth company

☒

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

☒

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

As of January 31, 2018, there were 37,758,056 shares of the registrant's common stock outstanding.

VAREX IMAGING CORPORATION
FORM 10-Q for the Quarter Ended December 29, 2017
INDEX

<u>Part I.</u>	<u>Financial Information</u>	<u>2</u>
<u>Item 1.</u>	<u>Unaudited Financial Statements</u>	<u>2</u>
	<u>Condensed Consolidated Statements of Earnings</u>	<u>2</u>
	<u>Condensed Consolidated Statements of Comprehensive Earnings</u>	<u>3</u>
	<u>Condensed Consolidated Balance Sheets</u>	<u>4</u>
	<u>Condensed Consolidated Statements of Cash Flows</u>	<u>5</u>
	<u>Notes to the Condensed Consolidated Financial Statements</u>	<u>6</u>
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>25</u>
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>32</u>
<u>Item 4.</u>	<u>Controls and Procedures</u>	<u>32</u>
<u>Part II.</u>	<u>Other Information</u>	<u>33</u>
<u>Item 1.</u>	<u>Legal Proceedings</u>	<u>33</u>
<u>Item 1A.</u>	<u>Risk Factors</u>	<u>33</u>
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>33</u>
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	<u>33</u>
<u>Item 4.</u>	<u>Mine Safety Disclosures</u>	<u>33</u>
<u>Item 5.</u>	<u>Other Information</u>	<u>33</u>
<u>Item 6.</u>	<u>Exhibits</u>	<u>33</u>
<u>Signatures</u>		<u>35</u>

PART I**FINANCIAL INFORMATION****Item 1. Financial Statements**

VAREX IMAGING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited)

(In millions, except per share amounts)	Three Months Ended	
	December 29, 2017	December 30, 2016
Revenues	\$ 176.2	\$ 157.4
Cost of revenues	114.7	98.6
Gross margin	61.5	58.8
Operating expenses:		
Research and development	19.7	13.3
Selling, general and administrative	28.2	26.9
Total operating expenses	47.9	40.2
Operating earnings	13.6	18.6
Interest income	0.1	0.1
Interest expense	(5.5)	(0.6)
Other (expense) income, net	(1.1)	0.2
Interest and other income (expense), net	(6.5)	(0.3)
Earnings before taxes	7.1	18.3
(Benefit) taxes on earnings	(4.3)	7.1
Net earnings	11.4	11.2
Less: Net earnings attributable to noncontrolling interests	0.1	0.1
Net earnings attributable to Varex	\$ 11.3	\$ 11.1
Net earnings per common share attributable to Varex		
Basic	\$ 0.30	\$ 0.30
Diluted	\$ 0.30	\$ 0.29
Weighted average common shares outstanding		
Basic	37.7	37.4
Diluted	38.2	37.7

See accompanying notes to the condensed consolidated financial statements.

VAREX IMAGING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS
(Unaudited)

(In millions)	Three Months Ended	
	December 29, 2017	December 30, 2016
Net earnings	\$ 11.4	\$ 11.2
Other comprehensive earnings, net of tax:		
Unrealized gain on interest rate swap contracts, net of tax expense of \$0.6 and \$0 during the three months ended December 29, 2017 and December 30, 2016, respectively	1.8	—
Other comprehensive earnings, net of tax	1.8	—
Comprehensive earnings	13.2	11.2
Less: Comprehensive earnings attributable to noncontrolling interests	0.1	0.1
Comprehensive earnings attributable to Varex	\$ 13.1	\$ 11.1

See accompanying notes to the condensed consolidated financial statements.

VAREX IMAGING CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In millions, except share amounts)	December 29, 2017	September 29, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 94.1	\$ 83.3
Accounts receivable, net	130.0	163.6
Inventories, net	245.3	234.5
Prepaid expenses and other current assets	14.5	13.9
Total current assets	483.9	495.3
Property, plant and equipment, net	144.1	148.3
Goodwill	241.9	241.9
Intangibles assets	87.1	91.3
Investments in privately-held companies	50.3	52.3
Other assets	12.8	11.0
Total assets	\$ 1,020.1	\$ 1,040.1
Liabilities, Redeemable Noncontrolling Interests and Equity		
Current liabilities:		
Accounts payable	\$ 58.3	\$ 58.9
Accrued liabilities	60.5	62.4
Current maturities of long-term debt	20.0	20.0
Deferred revenues	10.0	10.5
Total current liabilities	148.8	151.8
Long-term debt	434.5	463.9
Deferred tax liabilities	20.1	29.5
Other long-term liabilities	7.8	4.7
Total liabilities	611.2	649.9
Commitments and contingencies (Note 11)		
Redeemable noncontrolling interests	11.4	11.2
Equity:		
Preferred stock, \$.01 par value: 20,000,000 shares authorized, none issued	—	—
Common stock, \$.01 par value:		
Authorized shares - 150,000,000		
Issued shares - 37,753,118 and 37,633,747		
Outstanding shares - 37,753,118 and 37,633,747	0.4	0.4
Additional paid-in capital	348.1	342.7
Accumulated other comprehensive loss	2.6	0.8
Retained earnings	46.4	35.1
Total stockholders' equity	397.5	379.0
Total liabilities, redeemable noncontrolling interests and Varex stockholders' equity	\$ 1,020.1	\$ 1,040.1

See accompanying notes to the condensed consolidated financial statements.

VAREX IMAGING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In millions)	Three Months Ended	
	December 29, 2017	December 30, 2016
Cash flows from operating activities:		
Net earnings	\$ 11.4	\$ 11.2
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Share-based compensation expense	2.1	2.3
Depreciation	4.9	3.1
Amortization of intangible assets	4.2	1.3
Deferred taxes	(9.9)	5.2
Loss (income) from equity method investments	0.7	(0.1)
Amortization of deferred loan costs	0.6	—
Other, net	—	0.2
Changes in assets and liabilities:		
Accounts receivable	33.6	9.9
Inventories	(9.6)	(6.7)
Prepaid expenses and other assets	—	(2.4)
Accounts payable	1.5	(1.9)
Accrued operating liabilities and other long-term operating liabilities	1.1	(2.4)
Deferred revenues	(0.5)	(0.5)
Net cash provided by operating activities	40.1	19.2
Cash flows from investing activities:		
Purchases of property, plant and equipment	(2.6)	(5.0)
Other	—	0.7
Net cash used in investing activities	(2.6)	(4.3)
Cash flows from financing activities:		
Net transfers from parent	—	1.8
Borrowings under credit agreements	2.0	—
Repayments of borrowing under credit agreements	(32.0)	—
Proceeds from exercise of stock options	1.8	—
Proceeds from shares issued under employee stock purchase plan	1.4	—
Net cash (used in) provided by financing activities	(26.8)	1.8
Effects of exchange rate changes on cash and cash equivalents	0.1	0.7
Net increase in cash and cash equivalents	10.8	17.4
Cash and cash equivalents at beginning of period	83.3	36.5
Cash and cash equivalents at end of period	\$ 94.1	\$ 53.9
Supplemental cash flow information:		
Cash paid for interest	\$ 5.0	\$ —
Cash paid for income tax	0.2	—
Supplemental non-cash activities:		
Purchases of property, plant and equipment financed through accounts payable	\$ 2.0	\$ 3.6

See accompanying notes to the condensed consolidated financial statements.

VAREX IMAGING CORPORATION
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. DESCRIPTION OF BUSINESS

Varex Imaging Corporation (the “Company,” “Varex” or “Varex Imaging”) designs, manufactures, sells and services a broad range of X-ray imaging components, including X-ray tubes, digital detectors and accessories, high voltage connectors, high-energy inspection accelerators, image processing software and workstations, computer-aided diagnostic software, collimators, automatic exposure control devices, generators, ionization chambers and buckys, for use in a range of applications, including radiographic or fluoroscopic imaging, mammography, special procedures, computed tomography, radio therapy and computer-aided detection. The Company sells its products to imaging system original equipment manufacturer (“OEM”) customers for incorporation into new medical diagnostic, radiation therapy, dental, veterinary and industrial imaging systems, to independent service companies, distributors and directly to end-users for replacement purposes.

The Company also designs, manufactures, sells and services industrial products, which include Linatron® X-ray accelerators, imaging processing software and image detection products for security and inspection purposes, such as cargo screening at ports and borders and nondestructive examination in a variety of applications. The Company generally sells security and inspection products to OEM customers who incorporate Varex’s products into their inspection systems. The Company conducts an active research and development program to focus on new technology and applications in both the medical and industrial X-ray imaging markets.

Varex Imaging Corporation was incorporated in Delaware on July 18, 2016 for the purpose of holding the assets and liabilities associated with the Company's business and separated from Varian Medical Systems, Inc. (“Varian”) on January 28, 2017, upon which Varian completed the distribution of 100% of the outstanding common stock of Varex to Varian stockholders. Each Varian stockholder received 0.4 of a share of Varex common stock for every one share of Varian common stock held on the close of business on January 20, 2017. Following the separation and distribution, Varex became an independent publicly-traded company and is listed on the NASDAQ Global Select Market under the ticker “VREX.”

2. BASIS OF PRESENTATION AND PRINCIPLE OF CONSOLIDATION

The accompanying condensed consolidated financial statements are unaudited. These condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). In the opinion of management, these condensed consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods. Prior to the date of separation and distribution, the financial statements were prepared on a stand-alone basis and are derived from Varian’s consolidated financial statements and records as it operated as part of Varian prior to the distribution, in conformity with GAAP.

The condensed consolidated financial statements include the accounts of the Company and certain other assets and liabilities that were historically held at the Varian corporate level but are specifically identifiable and attributable to the Company. Prior to the separation and distribution, the condensed consolidated financial statements included allocations of certain Varian corporate expenses, including costs of information technology, human resources, accounting, legal, facilities, insurance, treasury and other corporate and infrastructure services. In addition, allocated costs included research and development expenses from Varian’s scientific research facility. Prior to the separation, these costs were allocated to the Company on the basis of direct usage when identifiable or other systematic measures that reflect utilization of services provided to or benefits received by the Company. The Company considers the expense allocation methodology and results to be reasonable for all periods presented.

These condensed consolidated financial statements and the accompanying notes are unaudited and should be read in conjunction with the financial statements for the fiscal years ended 2017, 2016 and 2015 included in the Company’s Form 10-K, which was filed with the SEC on December 13, 2017.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Segment Reporting

The Company has two reportable operating segments; (i) Medical and (ii) Industrial, which align with how its CEO, which has been identified as the Company's Chief Operating Decision Maker, views and measures the Company's business performance. See Note 17, "Segment Information" for further information on the Company's segments.

Fiscal Year

The fiscal years of the Company as reported are the 52 or 53-week period ending on the Friday nearest September 30. Fiscal year 2018 is the 52-week period ending September 28, 2018. Fiscal year 2017 was the 52-week period that ended on September 29, 2017. The first fiscal quarter of 2018 ended on December 29, 2017. The first fiscal quarter of 2017 ended on December 30, 2016.

Variable Interest Entities

For entities in which the Company has variable interests, the Company focuses on identifying which entity has the power to direct the activities that most significantly impact the variable interest entity's economic performance and which enterprise has the obligation to absorb losses or the right to receive benefits from the variable interest entity. If the Company is the primary beneficiary of a variable interest entity, the assets, liabilities and results of operations of the variable interest entity will be included in the Company's condensed consolidated financial statement. During the three months ended December 29, 2017, the Company had two variable interest entities, only one of which is consolidated, because it was determined that the Company was the primary beneficiary for that entity. As of December 29, 2017, total assets and liabilities for the consolidated variable interest entity was \$6.6 million and \$0.1 million, respectively.

Use of Estimates

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

Cash and Cash Equivalents

The Company considers currency on hand, demand deposits, time deposits and all highly-liquid investments with an original maturity of three months or less at the date of purchase to be cash and cash equivalents.

Fair Value

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. There is a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1—Quoted prices in active markets for identical assets or liabilities.

Level 2—Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or, other inputs that are observable or can be corroborated by observable market data.

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Derivative instruments and hedging activities

The Company records all derivatives on the balance sheet at fair value. For a derivative such as an interest rate swap that is designated as a cash flow hedge, the effective portion of changes in the fair value of the derivative is initially reported in accumulated other comprehensive income (loss) on the consolidated balance sheet and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings. To the extent the effective portion of a hedge subsequently becomes ineffective, the corresponding amount of the change in fair value of the derivative initially reported in accumulated other comprehensive income (loss) is reclassified and is recognized directly in earnings. Accordingly, on a quarterly basis, the Company assesses the effectiveness of each hedging relationship by comparing the changes in fair value or cash flows of the derivative hedging instrument with the changes in fair value or cash flows of a hypothetical designated perfect hedged item or transaction. If the change in the actual swap is greater than the change in the hypothetical perfect swap, the difference is referred to as “ineffectiveness” and is recognized in earnings in the current period.

Concentration of Risk

Financial instruments that potentially expose the Company to concentrations of credit risk consist principally of cash, cash equivalents and trade accounts receivable. Cash held with financial institutions may exceed the Federal Deposit Insurance Corporation insurance limits or similar limits in foreign jurisdictions. The Company has not experienced any losses on its deposits of cash and cash equivalents. The Company performs ongoing credit evaluations of its customers and, except for government tenders, group purchases and orders with a letter of credit, its industrial customers often provide a down payment. The Company maintains an allowance for doubtful accounts based upon the expected collectability of all accounts receivable. The Company obtains some of the components in its products from a limited group of suppliers or from a single-source supplier. The Company has neither experienced nor expects any significant disruptions to its operations due to supplier concentration.

Inventories

Inventories are valued at the lower of cost or net realizable value. Excess and obsolete inventories are determined primarily based on future demand forecasts, and write-downs of excess and obsolete inventories are recorded as a component of cost of revenues. Cost is computed using standard cost (which approximates actual cost) on a first-in-first-out basis.

Property, Plant and Equipment

Property, plant and equipment are stated at cost, net of accumulated depreciation. Major improvements are capitalized, while repairs and maintenance are expensed as incurred. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets. Land is not subject to depreciation, but land improvements are depreciated over fifteen years. Land leasehold rights and leasehold improvements are amortized over the lesser of their estimated useful lives or remaining lease terms. Buildings are depreciated over twenty years. Machinery and equipment are depreciated over their estimated useful lives, which range from three to seven years. Assets subject to lease are amortized over the lesser of their estimated useful lives or remaining lease terms. Estimated useful lives are periodically reviewed and, when appropriate, changes are made prospectively. When certain events or changes in operating conditions occur, asset lives may be adjusted, and an impairment assessment may be performed on the recoverability of the carrying amounts. When assets are retired or otherwise disposed of, the assets and related accumulated depreciation are removed from the accounts.

Investments

The Company accounts for its equity investments in privately-held companies under the equity method of accounting as the Company holds at least a 20% ownership interest or has the ability to exercise significant influence in these investments. The Company monitors these equity investments for impairment and makes appropriate reductions in carrying values if the Company determines that impairment charges are required based primarily on the financial condition and near-term prospects of these companies.

Goodwill and Intangible Assets

Goodwill is recorded when the purchase price of an acquisition exceeds the fair value of the net identified tangible and intangible assets acquired. Purchased intangible assets are carried at cost, net of accumulated amortization, and are included in other assets in the Company's condensed consolidated balance sheets. Intangible assets with finite lives are amortized over their estimated useful lives of primarily two to seven years using the straight-line method.

Impairment of Long-lived Assets, Intangible Assets and Goodwill

The Company reviews long-lived assets and identifiable intangible assets with finite lives for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. The Company assesses these assets for impairment based on their estimated undiscounted future cash flows. If the carrying value of the assets exceeds the estimated future undiscounted cash flows, the Company recognizes an impairment loss based on the excess of the carrying amount over the fair value of the assets. The Company did not recognize any impairment charges for long-lived assets and identifiable intangible assets during any of the periods presented.

The Company evaluates goodwill and indefinite lived intangible assets qualitatively for impairment at least annually in beginning of the fourth quarter of each fiscal year or whenever an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. If the Company determines that a quantitative analysis is necessary, the impairment test for goodwill is currently a two-step process. Step one consists of a comparison of the fair value of a reporting unit against its carrying amount, including the goodwill allocated to each reporting unit. The Company determines the fair value of its reporting units based on a combination of income and market approaches. The income approach is based on the present value of estimated future cash flows of the reporting units, and the market approach is based on a market multiple calculated for each reporting unit based on market data of other companies engaged in similar business. If the carrying amount of the reporting unit is in excess of its fair value, step two requires the comparison of the implied fair value of the reporting unit's goodwill against the carrying amount of the reporting unit's goodwill. Any excess of the carrying value of the reporting unit's goodwill over the implied fair value of the reporting unit's goodwill is recorded as an impairment loss. The impairment test for intangible assets with indefinite useful lives, if any, consists of a comparison of fair value to carrying value, with any excess of carrying value over fair value being recorded as an impairment loss.

No impairment charges were recognized as a result of the change in reporting units. The Company performs its annual goodwill impairment analysis during the fourth quarter of its fiscal year.

Loss Contingencies

From time to time, the Company is a party to or otherwise involved in legal proceedings, claims and government inspections or investigations and other legal matters, both inside and outside the United States, arising in the ordinary course of its business or otherwise. The Company accrues amounts, to the extent they can be reasonably estimated, that it believes are adequate to address any liabilities related to legal proceedings and other loss contingencies that it believes will result in a probable loss.

Product Warranty

The Company warrants most of its products for a specific period of time, usually 12 to 24 months from delivery or acceptance, against material defects. The Company provides for the estimated future costs of warranty obligations in cost of revenues when the related revenues are recognized. The accrued warranty costs represent the best estimate at the time of sale of the total costs that the Company will incur to repair or replace product parts that fail while still under warranty.

The amount of the accrued estimated warranty costs obligation for established products is primarily based on historical experience as to product failures adjusted for current information on repair costs. For new products, estimates include the historical experience of similar products, as well as reasonable allowance for warranty expenses associated with new products. On a quarterly basis, the Company reviews the accrued warranty costs and updates the historical warranty cost trends, if required.

Revenue Recognition

The Company's revenues are derived primarily from the sale of hardware and software products, and services. The Company recognizes its revenues net of any value added or sales tax and net of sales discounts.

The Company sells a high proportion of its X-ray products to a limited number of OEM customers. X-ray tubes, digital detectors and image-processing tools and security and inspection products are generally sold on a stand-alone basis. However, the Company occasionally sells its digital detectors, X-ray tubes and imaging processing tools as a package that is optimized for digital X-ray imaging and sells its Linatron[®] X-ray accelerators together with its imaging processing software and image detection products to OEM customers that incorporate them into their inspection systems. Service contracts are often sold with certain security and inspection products and computer-aided detection products. Revenues related to service contracts usually start after the expiration of the warranty period for non-software products or upon delivery of software products.

For a multiple-element arrangement that includes software and non-software deliverables which includes service contracts, the Company allocates revenues among the software and non-software deliverables on a relative selling price basis. The amounts allocated to the non-software products and software are accounted for as follows:

Non-Software Products

Non-software products include hardware products, software components that function together with the hardware components to deliver the product's essential functionality, as well as service contracts. Except as described below under "Service," the Company recognizes revenues for non-software products when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable and collectability is reasonably assured.

For multiple-element revenue arrangements that involve non-software products, a delivered non-software element is considered as a separate unit of accounting when it has stand-alone value. The allocation of revenue to all deliverables based on their relative selling prices is determined at the inception of the arrangement. The selling price for each deliverable is determined using vendor-specific objective evidence ("VSOE") of selling price, if it exists; otherwise, third-party evidence of selling price ("TPE") is used.

If the Company is not able to establish VSOE or TPE of selling prices for its non-software products, the Company uses the deliverable's estimated selling price ("ESP"). The Company estimates selling prices following an established process that considers market conditions, including the product offerings and pricing strategies of competitors, as well as internal factors such as historical pricing practices and margin objectives. The establishment of product and service ESPs is controlled and reviewed by the appropriate level of management in all of the Company's businesses.

The Company recognizes revenues upon the transfer of risk of loss, which is either at the time of shipment or delivery, depending upon the terms of the contract, provided that all other revenue recognition criteria have been met.

Software Products

The Company recognizes revenues for software products in accordance with the software revenue recognition guidance. The Company recognizes license revenues when all of the following criteria have been met: persuasive evidence of an arrangement exists, the vendor's fee is fixed or determinable, collection of the related receivable is probable and delivery of the product has occurred.

Revenues earned on software arrangements involving multiple elements are allocated to each element based on VSOE of fair value, which is based on the price charged when the same element is sold separately. In instances when evidence of VSOE of fair value of all undelivered elements exists, but evidence does not exist for one or more delivered elements, revenues are recognized using the residual method. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue. Revenue allocated to maintenance and support is recognized ratably over the maintenance term (typically one year).

For those software products that are not sold stand-alone or for which VSOE cannot be established or maintained, all software revenue under the contract will be deferred until the software product(s) that lack VSOE are all delivered. If the only undelivered software element that lacks VSOE is maintenance and support, then the software revenue would be recognized ratably over the term of the maintenance and support arrangement.

The Company recognizes revenues upon the transfer of risk of loss, which is either at the time of shipment or delivery, depending upon the shipping terms of the contract, provided that all other criteria for revenue recognition have been met.

Service

Service revenues include revenues from hardware and software service contracts, bundled support arrangements, paid services and trainings and parts that are sold by the service department. Revenues allocated to service contracts are recognized ratably over the period of performance of the related contracts. Revenues related to services performed on a time-and-materials basis are recognized when they are earned and billable.

Deferred Revenues

Deferred revenue primarily represents (i) the amount billed, billable or received applicable to non-software products for which parts and services under the warranty contracts have not been delivered, (ii) the amount billed, billable or received applicable to software products for which the Company's obligations under the maintenance contracts have not been fulfilled and (iii) the amount billed, billable or received for service contracts for which the services have not been rendered. Except for government tenders, group purchases and orders with letters of credit, the Company's security and inspection customers often provide a down payment prior to transfer of risk of loss of ordered products. These payments are also included in deferred revenue on the condensed consolidated balance sheets.

Share-Based Compensation Expense

The Company has an equity-based incentive plan that provides for the grant of nonqualified stock options and restricted stock units to directors, officers and other employees. The Company also permits employees to purchase shares under the Varex employee stock purchase plan. Prior to the separation, the Company's employees historically participated in Varian's equity-based incentive plans. Share-based compensation expense through the date of separation included allocations to the Company based on the awards and terms previously granted to its employees as well as an allocation of Varian's corporate and shared functional employee expenses.

The Company values stock options granted and the option component of the shares of common stock purchased under the equity-based incentive plans and stock purchased under the employee stock purchase plan using the Black-Scholes option-pricing model. Share-based compensation expense for restricted stock units is measured using the fair value of the Company's stock on the date of grant and is amortized over the award's respective service period. The Black-Scholes option-pricing model requires the input of certain assumptions, and changes in the assumptions can materially affect the fair value estimates of share-based payment awards.

The Company measures and recognizes expense for all share-based payment awards based on their fair values. Share-based compensation expense recognized in the condensed consolidated statements of earnings includes compensation expense for the share-based payment awards based on the grant date fair value estimated in accordance with the guidance on share-based compensation. Share-based compensation expense recognized is based on the value of the portion of share-based payment awards that is ultimately expected to vest. The Company attributes the value of share-based compensation to expense using the straight-line method. The Company considers only the direct tax impacts of share-based compensation awards when calculating the amount of tax windfalls or shortfalls.

Shipping and Handling Costs

Shipping and handling costs are included as a component of cost of revenues.

Research and Development

Research and development costs have been expensed as incurred. These costs primarily include employees' compensation, consulting fees and material costs.

Software Development Costs

Costs for the development of new software products and substantial enhancements to existing software products are expensed as incurred until technological feasibility has been established, at which time any additional costs would be capitalized. No costs associated with the development of software have been capitalized, as the Company believes its current software development process is essentially completed concurrent with the establishment of technological feasibility.

Taxes on Earnings

Taxes on earnings, as presented, are calculated in accordance with ASC 740, *Accounting for Income Taxes*. Under this guidance, each interim reporting period is considered integral to the annual period and tax expense is calculated using an estimated annual effective tax rate. The Company records tax expense each quarter based on its effective tax rate estimated for the full fiscal year and uses that rate to provide for income taxes on a current year-to-date basis, adjusted for discrete taxable events that occur during the interim period.

On December 22, 2017, the U.S. Government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Reform Act"). The Tax Reform Act significantly revised the U.S. corporate income tax structure by, among other things, lowering the U.S. corporate income tax rate, repealing certain deductions, and changing the way foreign earnings are taxed. U.S. GAAP requires that the impact of tax legislation be recognized in the period in which the law is enacted. As such, the Company's estimated annual effective tax rate for the current fiscal year includes the impact of the reduction of the U.S. statutory corporate income tax rate from 35% to 21% beginning January 1, 2018. As a September fiscal year end filer, the lower corporate income tax rate will be phased in resulting in a U.S. statutory federal rate of 24.5% for the fiscal year ending September 28, 2018. This phased in rate has been included in the estimated annual effective rate for the quarter. The current year-to-date income tax expense for the quarter also includes adjustments for other Tax Reform Act components that are discrete during the interim period as required by ASC 740. These include one-time adjustments for a tax on the deemed repatriation of foreign earnings and the revaluation of net deferred taxes.

Certain other provisions included in the Tax Reform Act have later effective dates for fiscal year filers and may have an impact on the Company's future effective tax rate. These include changes in the U.S. taxation of foreign earnings intended to reduce U.S. tax base erosion and the deferral of tax on foreign earnings. The changes included in the Tax Reform Act are broad, complex, and subject to interpretation. The SEC issued guidance under Staff Accounting Bulletin No. 118, *Income Tax Accounting Implications of the Tax Cuts and Jobs Act ("SAB 118")* that allows for reasonable estimated impacts to be recorded and a measurement period of up to one year from the date of enactment to revise these provisional amounts as new information is obtained and additional guidance is issued by various regulatory bodies. The amounts included in the current quarter represent provisional reasonable estimates and are anticipated to be finalized in subsequent periods but no later than December 22, 2018.

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

The Company is subject to taxes on earnings in both the United States and numerous foreign jurisdictions. Foreign earnings are generally taxed at rates that differ from the United States rates, earnings in certain foreign jurisdictions are currently subject to tax in the United States, and the benefit of losses generated in some other foreign jurisdictions is reduced due to full valuation allowance positions in those jurisdictions. Our effective tax rate is impacted by these factors as well as existing laws in both the United States and in the respective countries in which foreign subsidiaries do business. In addition, a change in the mix of earnings and losses among the various jurisdictions could increase or decrease our effective tax rate.

Foreign Currency Translation

The Company uses the U.S. Dollar as the functional currency of its foreign operations. Gains and losses from remeasurement of foreign currency balances into U.S. Dollars are included in the condensed consolidated statements of earnings.

Recent Accounting Standards or Updates Not Yet Effective

In August 2017, the FASB issued Accounting Standard Update ("ASU") 2017-12 which targets improvements to accounting for hedging activities which amends and simplifies existing guidance in order to allow companies to more accurately present the economic effects of risk management activities in the financial statements. The guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Company does not expect that the adoption of this guidance will have a material impact on its consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09 which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The guidance is effective for the Company beginning in the first quarter of fiscal year 2019. Early adoption is permitted. The Company does not expect that the adoption of this guidance will have a material impact on its consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07 which amended its guidance on the accounting related to defined benefit plans and other post-retirement benefits. This amendment requires the service cost component of net periodic pension and post-retirement benefit cost be presented in the same line item as other employee compensation costs, while the other components be presented separately as non-operating income (expense). The amendment will be effective for the Company beginning in its first quarter of fiscal year 2019. Early adoption is permitted. The Company is evaluating the impact of adopting this amendment to its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04 which clarified its guidance to simplify the measurement of goodwill by eliminating the Step 2 impairment test. The new guidance requires companies to perform the goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. The amendment will be effective for the Company beginning in its first quarter of fiscal year 2021. The amendment is required to be adopted prospectively. Early adoption is permitted. The Company is evaluating the impact of adopting this amendment to its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02 on accounting for leases. The new standard is intended to provide enhanced transparency and comparability by requiring lessees to record right-of-use assets and corresponding lease liabilities on the balance sheet. The new standard will continue to classify leases as either finance or operating, with classification affecting the pattern of expense recognition in the statement of earnings. The new standard is required to be adopted using a modified retrospective method to each prior reporting period presented with various optional practical expedients. The new standard will be effective for the Company beginning in its first quarter of fiscal year 2020 with early adoption permitted. The Company is evaluating the impact of adopting this new standard to its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, a new revenue standard, which sets forth a single, comprehensive revenue recognition model for all contracts with customers to improve comparability. The new standard requires revenue recognition to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In March 2016, the FASB amended the principal-versus-agent implementation guidance and illustrations in the new standard. In April 2016, the FASB amended the guidance on identifying performance obligations and the implementation guidance on licensing in the new standard. In May 2016, the FASB amended the guidance on collectability, noncash consideration, presentation of sales tax and transition in the new standard. The new standard will be effective for the Company beginning in its first quarter of fiscal year 2019, with early adoption permitted. The new standard can be applied either retrospectively to each prior reporting period presented (i.e., full retrospective adoption) or with the cumulative effect of initially applying the update recognized at the date of the initial application (i.e., modified retrospective adoption) along with additional disclosures. The Company is evaluating the timing and the impact of adopting this standard to its consolidated financial statements.

Accounting Standards Recently Adopted

In March 2016, the FASB issued ASU 2016-09 which includes an amendment to its accounting guidance related to employee share-based payments. The amendment simplifies several aspects of the accounting for employee share-based payments, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The Company retrospectively adopted this amendment in the first quarter of fiscal year 2018, resulting in an immaterial change on the Condensed Consolidated Balance Sheets.

4. BUSINESS COMBINATIONS

Acquisition of PerkinElmer's Medical Imaging Business

On May 1, 2017, the Company completed the acquisition of the Medical Imaging business of PerkinElmer, Inc. ("Acquired Detector Business") for \$273.3 million after post-closing working capital adjustments. The acquisition consisted of PerkinElmer Medical Holdings, Inc. and Dexela Limited, together with certain assets of PKI and its direct and indirect subsidiaries relating to digital flat panel X-ray detectors that serve as components for industrial, medical, dental and veterinary X-ray imaging systems. PKI Imaging has about 280 employees, is headquartered in Santa Clara, California and has additional operations in Germany, the Netherlands and the United Kingdom. The acquisition of PKI Imaging was pursuant to the Master Purchase and Sale Agreement, dated December 21, 2016 (the "Purchase Agreement"), by and between PKI and Varian and the subsequent Assignment and

Assumption Agreement, dated January 27, 2017, by and between Varian and Varex, pursuant to which Varian assigned and conveyed all of its rights, obligations, title and interest in the Purchase Agreement to Varex.

Unaudited Pro Forma Information

The unaudited pro-forma amounts presented below for the first quarter of fiscal year 2017 is presented for informational purposes only. In addition to the Company's results for the periods presented, the amounts below also include effects of the Acquired Detector Business as if it had been consummated on October 1, 2016. Audited results for the Acquired Detector Business for the fiscal years ended 2016 and 2015, are noted in the Company's Form 8-K/A filed with the SEC on July 7, 2017. These unaudited pro-forma results include effects that are directly attributable to the acquisition which include the amortization of intangible assets, interest expense, and other adjustments, including estimated tax effects. The unaudited pro-forma results do not reflect any operating efficiencies or potential cost savings which may result from the consolidation of the Acquired Detector Business and are not necessarily indicative of what the actual results of operations of the combined company would have been if the acquisition had occurred at the beginning of the period presented nor are they indicative of future results of operations or results that might have been achieved had the acquisition been consummated as of October 1, 2016.

(In millions)	Three Months Ended	
	December 30, 2016	
Revenue	\$	193.5
Operating earnings	\$	18.9
Net earnings	\$	9.2
Net earnings per share, basic	\$	0.24
Net earnings per share, diluted	\$	0.24

5. RELATED-PARTY TRANSACTIONS

Transactions with Varian Medical Systems, Inc.

During the three months ended December 29, 2017 and December 30, 2016, the Company recorded sales to Varian of \$3.0 million and \$5.4 million, respectively, and recorded purchases of products from Varian of \$0.4 million and \$0.4 million, respectively.

Allocated Costs

Prior to the separation on January 28, 2017, the condensed consolidated financial statements included allocations of corporate expenses from Varian to the Company. These allocated expenses included costs of information technology, human resources, accounting, legal, facilities, insurance, treasury and other corporate and infrastructure services. These costs were allocated to the Company on the basis of direct usage when identifiable or other systematic measures that reflect utilization of services provided to or benefits received by the Company.

Allocated costs included in the accompanying condensed consolidated statements of earnings are as follows:

(In millions)	Three Months Ended	
	December 30, 2016	
Selling, general and administrative	\$	11.9
Interest expense, net of interest income		0.5

Equity Method Investment

The Company has a 40% ownership interest in dpiX Holding LLC ("dpiX Holding"), a four-member consortium that has a 100% ownership interest in dpiX LLC ("dpiX"), a supplier of amorphous silicon based thin film transistor arrays for digital flat panel image detectors. In accordance with the dpiX Holding Agreement, net profits or losses are allocated to the members, in accordance with their ownership interests.

The equity investment in dpiX Holding is accounted for under the equity method of accounting. When the Company recognizes its share of net profits or losses of dpiX Holding, profits or losses in inventory purchased from dpiX are eliminated. During the three months ended December 29, 2017 and December 30, 2016, the Company recorded (loss) and income on the equity investment in dpiX Holding of \$(0.7) million and \$0.3 million, respectively. Income and loss on the equity investment in dpiX Holding is included in other income (expense), net in the condensed consolidated statements of earnings. The carrying value of the equity investment in dpiX Holding, which was included in investments in privately-held companies on the condensed consolidated balance sheets, was \$47.8 million and \$50.0 million at December 29, 2017 and September 29, 2017, respectively.

During the three months ended December 29, 2017 and December 30, 2016, the Company purchased glass transistor arrays from dpiX totaling \$6.6 million and \$8.4 million, respectively. These purchases of glass transistor arrays are included as a component of inventories on the condensed consolidated balance sheets or cost of revenues—product in the condensed consolidated statements of earnings for these fiscal years.

As of December 29, 2017 and September 29, 2017, the Company had accounts payable to dpiX totaling \$3.3 million and \$3.4 million, respectively.

In October 2013, the Company entered into an amended agreement with dpiX and other parties that, among other things, provides the Company with the right to 50% of dpiX's total manufacturing capacity produced after January 1, 2014. The amended agreement requires the Company to pay for 50% of the fixed costs (as defined in the amended agreement), as determined at the beginning of each calendar year. As of December 29, 2017, the Company did not yet have a fixed cost commitment related to this credit agreement. In January 2018, the fixed cost commitment was determined and approved by the dpiX board of directors to be \$16.3 million for calendar year 2018. The amended agreement will continue unless the ownership structure of dpiX changes (as defined in the amended agreement).

The Company has determined that dpiX is a variable interest entity because at-risk equity holders, as a group, lack the characteristics of a controlling financial interest. Majority votes are required to direct the manufacturing activities, legal operations and other activities that most significantly affect dpiX's economic performance. The Company does not have majority voting rights and no power to direct the activities of dpiX and therefore is not the primary beneficiary of dpiX. The Company's exposure to loss as a result of its involvement with dpiX is limited to the carrying value of the Company's investment and fixed cost commitments.

6. CONCENTRATION OF CREDIT RISK

Credit is extended to customers based on an evaluation of the customer's financial condition, and collateral is not required. During the periods presented, one customer accounted for a significant portion of revenues, which are as follows:

	Three Months Ended	
	December 29, 2017	December 30, 2016
Revenues to Toshiba Medical Systems	21.3%	24.1%

Toshiba Medical Systems accounted for 12.0% and 9.0% of the Company's accounts receivable as of December 29, 2017 and September 29, 2017, respectively.

7. FINANCIAL DERIVATIVES AND HEDGING ACTIVITIES

As part of the Company's overall risk management practices, the Company enters into financial derivatives, which include interest rate swaps designed as cash flow hedges, to hedge the LIBOR-based, floating interest rate on its debt.

The Company records all derivatives on the consolidated balance sheets at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting, and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting.

The effective portion of the gain or loss on derivative instruments designated and qualifying for cash flow hedge accounting is deferred in other comprehensive income. Any ineffectiveness in these designated hedging relationships is recognized in current period earnings. The changes in fair value for all trades that are not designated for hedge accounting are recognized in current period

earnings. Deferred gains or losses from designated cash flow hedges are reclassified into earnings in the period that the hedged interest expense effect earnings. The effectiveness of cash flow hedges is assessed at inception and quarterly thereafter. If the instrument were to no longer qualify for hedge accounting due to it becoming probable that the originally-forecasted hedged transactions will not occur, then hedge accounting would cease and the related change in fair value of the ineffective portion of the derivative instrument would be reclassified from accumulated other comprehensive income (loss) and recognized in earnings. The Company does not offset fair value amounts recognized for derivative instruments in its balance sheet for presentation purposes.

Credit risk related to derivative transactions reflects the risk that a party to the transaction could fail to meet its obligation under the derivative contracts. Therefore, the Company's exposure to the counterparty's credit risk is generally limited to the amounts, if any, by which the counterparty's obligations to the Company exceed the Company's obligations to the counterparty. The Company's policy is to enter into contracts only with financial institutions which meet certain minimum credit ratings to help mitigate counterparty credit risk.

Derivatives Designated as Hedging Instruments - Cash Flow Hedges

The Company uses interest rate swap contracts as cash flow hedges to manage its exposure to fluctuations in LIBOR interest rates. Interest rate swap contracts hedging variable rate debt effectively fix the LIBOR component of its interest rate for a specific period of time.

The effective portion of changes in the fair value of derivatives designated and qualifying as cash flow hedges is deferred as a component of accumulated other comprehensive income in the accompanying consolidated balance sheets and is subsequently reclassified into earnings in the period that the hedged interest expense effects earnings. The ineffective portion of the changes in fair value of derivatives designated as cash flow hedges are recognized directly to earnings and reflected in the accompanying condensed consolidated statements of earnings. No ineffectiveness was reported in earnings for the period ending December 29, 2017.

As of December 29, 2017, the Company had the following outstanding derivatives designated as hedging instruments:

(In millions, except for number of instruments)		Number of Instruments	Notional Value
Interest Rate Swap Contracts		6	\$ 288.8

These contracts have maturities of four years or less.

The following table summarizes the amount of income recognized from derivative instruments for the periods indicated and the line items in the accompanying statements of operations where the results are recorded for cash flow hedges:

(In millions)	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion) Three months ended		Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Three months ended		Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) Three months ended	
	2017	2016		2017	2016		2017	2016
Interest Rate Swap Contracts	\$ 2.1	\$ —	Interest expense	\$ (0.3)	\$ —	Interest expense	\$ —	\$ —

The Company expects that approximately \$(1.0) million recorded as a component of accumulated other comprehensive income (loss) will be realized in the statements of earnings over the next 12 months and the amount will vary depending on interest rates.

These derivative instruments are subject to master netting agreements giving effect to rights of offset with each counterparty. The following table summarizes the fair values of derivative instruments as of the periods indicated and the line items in the

accompanying consolidated balance sheets where the instruments are recorded:

(In millions)	Derivative Assets		Derivative Liabilities	
		December 29, 2017	September 29, 2017	
<u>Derivatives designated as cash flow hedges</u>	<u>Balance sheet location</u>			<u>Balance sheet location</u>
Interest rate swap contracts	Other non-current assets	\$ 3.1	\$ 1.6	Other non-current liabilities
Interest rate swap contracts	Other current assets	0.2	—	Other current liabilities
		<u>\$ 3.3</u>	<u>\$ 1.6</u>	
				<u>\$ —</u>
				<u>\$ (0.6)</u>

8. FAIR VALUE

Assets/Liabilities Measured at Fair Value on a Recurring Basis

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

(In millions)	Fair Value Measurements at December 29, 2017			
	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:				
Cash equivalents - Money market funds	\$ —	\$ 15.3	\$ —	\$ 15.3
Interest rate swap contracts	—	3.3	—	3.3
Total assets measured at fair value	\$ —	\$ 18.6	\$ —	\$ 18.6

As of December 29, 2017, the outstanding borrowings under the Company's credit agreement were \$454.5 million, net of deferred loan costs, which approximated its fair value. The fair values of certain of the Company's financial instruments, including bank deposits included in cash and cash equivalents, accounts receivable and accounts payable, also approximate their fair values due to their short maturities. There were no financial assets or liabilities measured on a recurring basis using significant unobservable inputs (Level 3) and there were no transfers in or out of Level 1, 2 or 3 during the three months ended December 29, 2017.

At September 29, 2017, the Company determined the following levels of inputs at fair value for following assets or liabilities:

(In millions)	Fair Value Measurements at September 29, 2017			
	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:				
Cash equivalents - Money market funds	\$ —	\$ 11.4	\$ —	\$ 11.4
Interest rate swap contracts	—	1.6	—	1.6
Total assets measured at fair value	\$ —	\$ 13.0	\$ —	\$ 13.0
Liabilities:				
Interest rate swap contracts	\$ —	\$ 0.6	\$ —	\$ 0.6

9. INVENTORY, NET

The following table summarizes the Company's inventories, net:

(In millions)	December 29, 2017	September 29, 2017
Raw materials and parts, net	\$ 169.6	\$ 164.5
Work-in-process, net	27.1	20.3
Finished goods, net	48.6	49.7
Total inventories, net	<u>\$ 245.3</u>	<u>\$ 234.5</u>

10. GOODWILL AND INTANGIBLE ASSETS

The following table reflects goodwill by reportable operating segment:

(In millions)	Medical	Industrial	Total
Balance at September 29, 2017	\$ 146.9	\$ 95.0	\$ 241.9
Balance at December 29, 2017	\$ 146.9	\$ 95.0	\$ 241.9

There were no additions to goodwill or impairment charges against goodwill during the three months ended December 29, 2017 and December 30, 2016.

The following table reflects the gross carrying amount and accumulated amortization of the Company's finite-lived intangible assets included in other assets in the condensed consolidated balance sheets:

(In millions)	December 29, 2017	September 29, 2017
Acquired existing technology	\$ 57.0	\$ 57.0
Patents, licenses and other	19.4	19.4
Customer contracts and supplier relationship	42.1	42.1
Accumulated amortization	(35.4)	(31.2)
Total intangible assets with finite lives	83.1	87.3
In-process research and development with indefinite lives	4.0	4.0
Total intangible assets	<u>\$ 87.1</u>	<u>\$ 91.3</u>

Amortization expense for intangible assets was \$4.2 million and \$1.3 million for the three months ended December 29, 2017 and December 30, 2016, respectively.

11. COMMITMENTS AND CONTINGENCIES

Product Warranty

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

(In millions)	Warranty Allowance
Accrued product warranty, September 29, 2017	\$ 7.0
Charged to cost of revenues	3.4
Product warranty expenditures	(2.8)
Accrued product warranty, December 29, 2017	<u>\$ 7.6</u>

Other Commitments

See Note 5, "Related Party Transactions" for additional information about the Company's commitments to dpiX.

See Note 13, "Noncontrolling Interests" for additional information about the Company's commitment to the noncontrolling shareholders of MeVis.

Contingencies

From time to time, the Company is a party to or otherwise involved in legal proceedings, claims and government inspections or investigations and other legal matters, both inside and outside the United States, arising in the ordinary course of its business or otherwise. The Company accrues amounts, to the extent they can be reasonably estimated, that it believes are adequate to address any liabilities related to legal proceedings and other loss contingencies that the Company believes will result in a probable loss (including, among other things, probable settlement value). A loss or a range of loss is disclosed when it is reasonably possible that a material loss will be incurred and can be estimated or when it is reasonably possible that the amount of a loss, when material, will exceed the recorded provision. The Company did not have any contingent liabilities as of December 29, 2017 and September 29, 2017. Legal expenses are expensed as incurred.

12. BORROWINGS

Credit Facility

On January 25, 2017, the Company entered into a revolving credit facility (the "Previous Revolving Credit Facility"), which matured in five years, and a term facility (the "Previous Term Facility"), which was to be repaid over five years, with 7.5% payable in quarterly installments during the first two years, 10% payable in quarterly installments during the third and fourth years and 15% payable in quarterly installments in the fifth year. The credit agreement relating to the Previous Revolving Credit Facility and the Previous Term Facility (the "Previous Credit Agreement") contained various customary restrictive covenants that limited, among other things, the incurrence of indebtedness by Varex and its subsidiaries, the grant or incurrence of liens by Varex and its subsidiaries, the entry into sale and leaseback transactions by Varex and its subsidiaries, and the entry into certain fundamental change transactions by Varex and its subsidiaries. It also contained customary events of default and certain financial covenants, including the requirement to maintain certain financial ratios. The Previous Credit Agreement was secured by the stock and assets of certain Varex subsidiaries. The Previous Credit Agreement had several borrowing and interest rate options including the following indices: (i) the LIBOR rate, or (ii) the base rate (equal to the greater of the prime rate, the federal funds rate plus 0.50% or the LIBOR rate for a one-month period plus 1.00%). Loans under the Previous Credit Agreement bore interest at a rate per annum using the applicable indices plus a varying interest rate margin of between 1.125% and 2.125%. The Previous Credit Agreement also provided for fees applicable to amounts available to be drawn under outstanding letters of credit of 0.125% and a fee on unused commitments which ranges from 0.20% to 0.40%. On January 25, 2017, Varex borrowed \$203 million under Previous Term Facility and transferred \$200.0 million to Varian.

On May 1, 2017 and in connection with the acquisition of PKI Imaging, Varex entered into a new secured revolving credit facility (the "Revolving Credit Facility") in an aggregate principal amount of up to \$200 million with a five-year term, and a secured term facility (the "Term Facility" and together with the Revolving Credit Facility, the "Credit Agreement") in an aggregate principal amount of \$400 million. The Term Facility will be repaid over five years, with 5.0% payable in quarterly installments during each of the first two years of the term thereof, 7.5% payable in quarterly installments during the third and fourth years of the term thereof, and 10% payable in quarterly installments in the fifth year of the term thereof, with the remaining amount due at maturity. Varex used the net proceeds from the Term Facility, and the net proceeds from approximately \$97 million drawn on the Revolving Credit Facility, to pay the approximately \$276 million purchase price for the acquisition of PKI Imaging, plus related credit facility fees, and to repay all of Varex's obligations under the Previous Credit Agreement.

The Credit Agreement contains various customary restrictive covenants that limits, among other things, the incurrence of indebtedness by Varex and its subsidiaries, the grant or incurrence of liens by Varex and its subsidiaries, the entry into sale and leaseback transactions by Varex and its subsidiaries, and the entry into certain fundamental change transactions by Varex and its subsidiaries. It also contains customary events of default and certain financial covenants, including the requirement to maintain certain financial ratios. The Credit Agreement is secured by the stock and assets of Varex's material subsidiaries. The Credit Agreement has several borrowing and interest rate options including the following indices: (a) LIBOR rate, or (b) the base rate (equal to the greater of the prime rate, the federal funds rate plus 0.50% or the LIBOR rate for a one-month period plus 1.00%). Loans under the Credit Agreement bear interest at a rate per annum using the applicable indices plus a varying interest rate margin of between 1.75% and 2.75% (for LIBOR rate loans) and 0.75%-1.75% (for base rate loans). The Credit Agreement also provides for fees applicable to amounts available to be drawn under outstanding letters of credit of 0.125%, and a fee on unused commitments which ranges from 0.25% to 0.40%.

The following table summarizes the Company's total debt outstanding:

(Dollars in millions)	December 29, 2017		September 29, 2017	
	Amount	Weighted-Average Interest Rate	Amount	Weighted-Average Interest Rate
Current portion of Term Facility	\$ 20.0	4.08%	\$ 20.0	4.07%
Revolving Credit Facility	79.0	3.77%	104.0	3.75%
Long-Term portion of Term Facility	365.0	4.08%	370.0	4.07%
Debt issuance costs	(9.5)		(10.1)	
Total debt outstanding	<u>\$ 454.5</u>		<u>\$ 483.9</u>	

13. REDEEMABLE NONCONTROLLING INTERESTS

In April 2015, the Company completed the acquisition of 73.5% of the then outstanding shares of MeVis, a public company based in Bremen, Germany that provides image processing software and services for cancer screening.

In August 2015, the Company, through one of its German subsidiaries, entered into a Domination and Profit and Loss Transfer Agreement (the "DPLTA") with MeVis. In October 2015, the DPLTA became effective upon its registration at the local court of Bremen, Germany. Under the DPLTA, MeVis subordinates its management to the Company and undertakes to transfer all of its annual profits and losses to the Company. In return, the DPLTA grants the noncontrolling shareholders of MeVis: (1) an annual recurring net compensation of €0.95 per MeVis share starting from January 1, 2015; and (2) a put right for their MeVis shares at €19.77 per MeVis share. Upon effectiveness of the DPLTA, the noncontrolling interests in MeVis became redeemable as a result of the put right and were reclassified to temporary equity.

Changes in redeemable noncontrolling interests relating to MeVis were as follows:

(In millions)	Redeemable Noncontrolling Interests
Balance at beginning of period, September 29, 2017	\$ 11.2
Net earnings attributable to noncontrolling interests	—
Other, including foreign currency remeasurement	0.2
Balance at end of period, December 29, 2017	<u>\$ 11.4</u>

At December 29, 2017, noncontrolling shareholders together held approximately 0.5 million shares of MeVis, representing 26.3% of the outstanding shares.

14. NET EARNINGS PER SHARE

Basic net earnings per common share is computed by dividing the net earnings for the period by the weighted average number of shares of common stock outstanding during the reporting period. Diluted net earnings per common share reflects the effects of potentially dilutive securities, which is computed by dividing net earnings by the sum of the weighted average number of common shares outstanding and dilutive common shares, which consists stock options and unvested restricted stock.

A reconciliation of the numerator and denominator used in the calculation of basic and diluted net income per common share is as follows:

(In millions, except per share amounts)	Three Months Ended	
	December 29, 2017	December 30, 2016 ⁽¹⁾
Net earnings attributable to Varex	\$ 11.3	\$ 11.1
Weighted average shares outstanding - basic	37.7	37.4
Dilutive effect of potential common shares	0.5	0.3
Weighted average shares outstanding - diluted	38.2	37.7
Net earnings per share attributable to Varex - basic	\$ 0.30	\$ 0.30
Net earnings per share attributable to Varex - diluted	\$ 0.30	\$ 0.29
Anti-dilutive employee shared based awards, excluded	1.0	0.7

(1) Basic and diluted net earnings for the three months ended December 30, 2016 is calculated using the number of common shares distributed on January 28, 2017.

The Company excludes potentially dilutive common shares (consisting of shares underlying stock options and the employee stock purchase plan) from the computation of diluted weighted average shares outstanding if the inclusion of the shares underlying these stock awards would be anti-dilutive to earnings per share.

15. EMPLOYEE STOCK PLANS

Employee Stock Plans

Prior to the separation and distribution, the Company's employees participated in Varian's stock-based compensation plans, which provided for the grants of stock options, restricted stock units and performance shares among other types of awards under Varian's Third Amended and Restated 2005 Omnibus 2005 Stock Plan (the "Third Amended 2005 Plan"). The expense associated with the Company's employees who participated in the Third Amended 2005 Plan is included in the accompanying condensed consolidated statements of earnings. Subsequent to the separation and distribution, the Company's employees participate in Varex's 2017 Omnibus Stock Plan and 2017 Employee Stock Purchase Plan.

Share-Based Compensation Expense

As share-based compensation expense recognized in the condensed consolidated statements of earnings is based on awards ultimately expected to vest. Share-based compensation expense includes expenses related to the Company's direct employees. Prior to the separation, Varian also charged the Company for the allocated share-based compensation costs of certain employees of Varian who provided selling, general and administrative services on the Company's behalf.

The table below summarizes the effect of recording share-based compensation expense and for the option component of the employee stock purchase plan shares:

(In millions)	Three Months Ended	
	December 29, 2017	December 30, 2016 ⁽¹⁾
Cost of revenues	\$ 0.2	\$ 0.2
Research and development	0.4	0.4
Selling, general and administrative	1.5	1.7
Total share-based compensation expense	\$ 2.1	\$ 2.3

(1) Includes allocated share-based compensation of \$0.8 million for the three months ended December 30, 2016, charged by Varian to the Company for certain Varian employees who provided general and administrative services on the Company's behalf.

Stock Option Activity

The following table summarizes the activity for stock options under Varex's employee incentive plans for the Company's employees:

(In thousands, except per share amounts and the remaining term)	Options Outstanding			
	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Term (in years)	Aggregate Intrinsic Value (1)
Balance at September 29, 2017	1,926	\$ 29.11		
Granted	8	37.60		
Canceled, expired or forfeited	—	—		
Exercised	(69)	26.32		
Balance at December 29, 2017	1,865	\$ 29.25	5.1	\$ 20,353
Exercisable at December 29, 2017	679	\$ 26.82	3.5	\$ 9,068

(1) The aggregate intrinsic value represents the total pre-tax intrinsic value, which is computed based on the difference between the exercise price and the closing price of Varex common stock of \$40.17 as of December 29, 2017, the last trading date of the Company's first quarter, and which represents the amount that would have been received by the option holders had all option holders exercised their options and sold the shares received upon exercise as of that date.

Restricted Stock Units

The following table summarizes the activity for restricted stock units under Varex's employee incentive plans for the Company's employees:

(In thousands, except per share amounts)	Number of Shares	Weighted Average Grant-Date Fair Value
Balance at September 29, 2017	525	\$ 29.76
Granted	3	37.60
Vested	—	—
Canceled or expired	—	—
Balance at December 29, 2017	528	\$ 29.82

16. TAXES ON EARNINGS

	Three Months Ended	
	December 29, 2017	December 30, 2016
Estimated effective tax rate	(60.6)%	38.8%

The Company recognized an income tax benefit of \$4.3 million and expense of \$7.1 million for the three months ended December 29, 2017 and December 30, 2016, respectively, for effective rates of (60.6)% and 38.8%, respectively.

The Company's effective tax rate decreased primarily due to the enactment of the Tax Reform Act in the U.S. during the period. The Tax Reform Act significantly revised the U.S. corporate income tax structure. Among the revisions impacting the Company's effective tax rate are a lower U.S. corporate statutory rate going from 35% to 21% effective January 1, 2018, a repeal of the deduction for domestic production activities, and changes to the way foreign earnings are taxed. As a September fiscal year filer, the lower corporate income tax rate will be phased in resulting in a U.S. statutory federal rate of 24.5% for the fiscal year ending September 28, 2018. U.S. GAAP requires the impact of tax legislation to be recognized in the period in which the law is enacted. The lower U.S. statutory rate has been included in the estimated annual effective rate used to calculate the year-to-date income tax benefit as of the end of the quarter. The repeal of the deduction for domestic production does not apply to the Company until the fiscal year beginning September 29, 2018, and so has also been included in the calculation of the estimated annual effective rate. Also, as a result of the Tax Reform Act, the Company recorded income tax expense of \$3.4 million for the tax on the deemed repatriation of deferred foreign earnings offset by a tax benefit of \$9.5 million due to the revaluation of net deferred taxes. The \$3.4 million of tax on the deemed repatriation of foreign earnings has been reduced by the utilization of an estimated foreign tax credit carryforward from the prior fiscal year which was previously subject to a full valuation allowance. The anticipated utilization of this deferred tax asset

resulted in the release of that valuation allowance and the benefit of approximately \$1.9 million has been included in the income tax benefit for the quarter.

The changes included in the Tax Reform Act are broad, complex, and subject to interpretation. In addition, the calculation of the impact of certain provisions is dependent on amounts such as current year earnings and year end balances that, while they can be reasonably estimated, will only become final at the end of future accounting periods. On December 22, 2017, the SEC issued SAB 118, allowing registrants to consider the estimated impact of the U.S. legislation as “provisional” when it does not have the information necessary to complete the accounting for the change in tax law. In accordance with SAB 118, the tax on the deemed repatriation of foreign earnings of \$3.4 million and the benefit of \$9.5 million for the revaluation of net deferred taxes represent the Company’s best and reasonable estimate based on interpretation of the U.S. legislation, are considered provisional, and will be finalized before December 22, 2018. These provisional estimates may be revised as adjustments to tax expense in subsequent periods as additional information is obtained and as additional guidance is issued by regulatory bodies.

Certain other provisions included in the Tax Reform Act have later effective dates for fiscal year filers and may have an impact on the Company’s future effective tax rate. These include, but are not limited to, changes in the taxation of foreign earnings. The Company is in the process of analyzing the effects of these provisions including GILTI (global intangible low-taxed income), BEAT (base-erosion anti-abuse tax), FDII (foreign-derived intangible income), limitations on interest expense deductions (if certain conditions apply), and other components of the Tax Reform Act. The Company has elected to account for GILTI as a period cost if and when incurred pursuant to the exposure draft issued by the FASB in January 2018. Other future adjustments to tax expense may include the impact of actions the Company may take as a result of the Tax Reform Act.

17. SEGMENT INFORMATION

The Company has two reportable operating segments; (i) Medical and (ii) Industrial, which align with how its CEO views and measures the Company's business performance. The Company's CEO is the Chief Operating Decision Maker and allocates resources to and evaluates the financial performance of each operating segment primarily based on revenues and gross margin.

Description of Segments

The Medical segment designs, manufactures, sells and services X-ray imaging components for use in a range of applications, including radiographic or fluoroscopic imaging, mammography, special procedures, computed tomography, radiation therapy and computer-aided detection. The Company provides a broad range of X-ray imaging components for Medical customers including X-ray tubes, digital detectors, high voltage connectors, image-processing software and workstations, computer-aided diagnostic software, collimators, automatic exposure control devices, generators, ionization chambers and buckys. The Company’s X-ray imaging components are primarily sold to imaging system OEM customers that incorporate them into their medical diagnostic, radiation therapy, dental, veterinary and industrial imaging systems. The Company also sells its X-ray imaging components to independent service companies, distributors and directly to end-users for replacement purposes.

The Industrial segment designs, manufactures, sells and services security and inspection products, which include Linatron X-ray accelerators, X-ray tubes, digital detectors, high voltage connectors, image processing software and image detection products for security and inspection purposes, such as cargo screening at ports and borders and nondestructive examination in a variety of applications. The Company generally sells its Industrial products to OEM customers that incorporate its products into their inspection systems.

Accordingly, the following information is provided for purposes of achieving an understanding of operations, but it 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.

Information related to the Company’s segments is as follows:

(In millions)	Three Months Ended	
	December 29, 2017	December 30, 2016
Revenues		
Medical	\$ 139.2	\$ 131.7
Industrial	37.0	25.7
Total revenues	176.2	157.4
Gross margin		
Medical	46.4	47.1
Industrial	15.1	11.7
Total gross margin	61.5	58.8
Total operating expenses	47.9	40.2
Interest and other income (expenses), net	(6.5)	(0.3)
Earnings before taxes	7.1	18.3
Taxes on earnings	(4.3)	7.1
Net earnings	11.4	11.2
Less: Net earnings attributable to noncontrolling interests	0.1	0.1
Net earnings attributable to Varex	\$ 11.3	\$ 11.1

The following table summarizes the Company's total assets by its reportable segments:

(In millions)	December 29, 2017	September 29, 2017
Identifiable assets		
Medical	\$ 805.9	\$ 832.1
Industrial	214.2	208.0
Total reportable segments	\$ 1,020.1	\$ 1,040.1

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

The following discussion and analysis of the financial condition and results should be read together with our Annual Report on Form 10-K for the fiscal year ended 2017 and our Form 10 filed on January 12, 2017, for the fiscal years ended 2016, 2015 and 2014.

Forward-Looking Statements

This Quarterly Report on Form 10-Q (this "Quarterly Report") contains "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995, which provides a "safe harbor" for statements about future events, products and future financial performance that are based on the beliefs of, estimates made by, and information currently available to the management of Varex Imaging Corporation ("we," "our," "us," the "Company," "Varex," or "Varex Imaging"). The outcome of the events described in these forward-looking statements is subject to risks and uncertainties. Actual results and the outcome or timing of certain events may differ significantly from those projected in these forward-looking statements or management's current expectations due to the factors cited in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A"), the Risk Factors listed under Part II, Item 1A of this Quarterly Report and other factors described from time to time in our other filings with the U.S. Securities and Exchange Commission (the "SEC"), or other reasons. For this purpose, statements concerning: industry or market segment outlook; market acceptance of or transition to new products or technology such as advanced X-ray tube and flat panel products; growth drivers; future orders, revenues, backlog, earnings or other financial results; and any statements using the terms "believe," "expect," "anticipate," "can," "should," "would," "could," "estimate," "may," "intended," "potential," and "possible" or similar statements are forward-looking statements that involve risks and uncertainties that could cause our actual results and the outcome and timing of certain events to differ materially from those projected or management's current expectations. By making forward-looking statements, we have not assumed any obligation to, and you should not expect us to, update or revise those statements because of new information, future events or otherwise.

Separation and Distribution

On January 28, 2017, Varian completed its separation and distribution of Varex. In connection with the distribution, Varex became an independent publicly-traded company and is listed on the NASDAQ Global Select Market under the ticker "VREX" with 37.4 million shares of common shares distributed to Varian shareholders.

A summary of certain material features of the agreements can be found in the section entitled "Relationships with Varian Following Separation and Distribution" in Varex's Information Statement dated January 20, 2017 (the "Information Statement"), which was included as Exhibit 99.1 to Varex's Current Report on 8-K filed with the Securities and Exchange Commission on January 20, 2017.

Overview

Varex Imaging Corporation is a leading innovator, designer and manufacturer of X-ray imaging components, which include tubes, digital flat panel detectors and other image processing solutions, which are key components of X-ray imaging systems. With a 65+ year history of successful innovation, Varex's components are used in medical imaging as well as in industrial and security imaging applications. Global OEM manufacturers of X-ray imaging systems use the company's X-ray sources, digital detectors, connecting devices and imaging software as components in their systems to detect, diagnose and protect. Varex has approximately 1,900 full-time equivalents employees, located at manufacturing and service center sites in North America, Europe, and Asia. For more information about Varex, visit vareximaging.com.

On May 1, 2017, we acquired the Medical Imaging business of PerkinElmer, Inc. ("Acquired Detector Business") for \$273.3 million. The acquisition consisted of PerkinElmer Medical Holdings, Inc. and Dexela Limited, together with certain assets of PKI and its direct and indirect subsidiaries relating to digital flat panel detectors that serve as components for industrial, medical, dental and veterinary X-ray imaging systems. The acquired business included approximately 280 employees with operations in Santa Clara, California as well as operations in Germany, the Netherlands and the United Kingdom. We believe the acquisition complements our existing imaging detector business and will provide increased expertise and opportunities for Varex in the future.

Our products are sold in three geographic regions: The Americas, EMEA, and APAC. The Americas includes North America (primarily United States) and Latin America. EMEA includes Europe, Russia, the Middle East, India and Africa. APAC includes Asia and Australia. Revenues by region are based on the known final destination of products sold.

Our success depends upon our ability to anticipate changes in our markets, the direction of technological innovation and the demands of our customers. A significant portion of our customers are outside of the United States, and products in this business are generally priced in U.S. Dollars. Demand for our products can be negatively impacted by the strengthening of the U.S. Dollar, and can cause our products to be priced higher compared to products sold in non-U.S. Dollar currencies. We are continuing to have some

customers ask for additional discounts, delay purchasing decisions, or move to in-sourcing supply of such components or migrate to lower cost alternatives. The market for border protection systems has stabilized; however, end customers, particularly in oil-based economies and war zones in which we have a significant customer base, continue to delay tenders, resulting in reduced demand for security products.

Our Chief Executive Officer, who is our Chief Operating Decision Maker (“CODM”), evaluates the product groupings and measures the business performance in two reportable operating segments: Medical and Industrial. The segments align our products and service offerings with customer use in medical and industrial markets and are consistent with how the CODM evaluates the business for the allocation of resources. The CODM allocates resources to and evaluates the financial performance of each operating segment primarily based on revenues and gross margin.

Medical

In our Medical business segment, we design, manufacture, sell and service X-ray imaging components for use in a range of applications, including radiographic or fluoroscopic imaging, mammography, special procedures, computed tomography (“CT”), radiation therapy and computer-aided detection. We provide a broad range of X-ray imaging components for Medical customers, including X-ray tubes, flat panel digital image detectors, high voltage connectors, image-processing software and workstations, computer-aided diagnostic software, collimators, automatic exposure control devices, generators, ionization chambers and buckys.

A significant portion of our revenues come from the sales of high-end X-ray tubes used in CT imaging and high-end dynamic digital detectors used in fluoroscopic and dental applications. These upper-tier imaging components are characterized by increased levels of technological complexity, engineering and intellectual property that typically allow these products to have a higher sales price and gross margin.

The digital detector market continues to mature from initial product introductions approximately 10 years ago. For the past few years, we have experienced price erosion for these products, predominantly in the highly-competitive market for radiographic detectors. We anticipate this trend will continue in the foreseeable future.

Our X-ray imaging components are primarily sold to imaging system original equipment manufacturer (“OEM”) customers that incorporate them into their medical diagnostic, radiation therapy, dental and veterinary imaging systems. To a much lesser extent, we also sell our X-ray imaging components to independent service companies, distributors and directly to end-users for replacement purposes.

Industrial

In our Industrial business segment, we design, manufacture, sell and service products for use in security and industrial inspection applications, such as cargo screening at ports and borders and nondestructive examination in a variety of applications. The products include Linatron X-ray accelerators, X-ray tubes, digital detectors, high voltage connectors, image-processing software and image detection products that we generally sell to OEM customers that incorporate these products into their inspection systems.

Basis of Presentation

Prior to the separation and distribution, our historical condensed consolidated financial statements have been prepared on a stand-alone basis and were derived from Varian’s consolidated financial statements and records as we operated as part of Varian. Following the separation and distribution, the condensed consolidated financial statements reflect our financial position, results of operations, comprehensive earnings and cash flows in conformity with U.S. generally accepted accounting principles (“GAAP”).

For periods prior to the separation and distribution, the condensed consolidated financial statements include allocation of certain Varian corporate expenses including costs of information technology, human resources, accounting, legal, facilities, insurance, treasury and other corporate and infrastructure services. In addition, allocated costs include research and development expenses from Varian’s scientific research facility. These costs were allocated to us on the basis of direct usage when identifiable or other systematic measures that reflect utilization of services provided to or benefits received. We consider the expense allocation methodology and results to be reasonable for all periods presented. The condensed consolidated financial statements also include certain assets and liabilities that have historically been held at the Varian corporate level, but which are specifically identifiable and attributable to us. Our condensed consolidated financial position, results of operations, comprehensive earnings and cash flows prior to the separation

may not be indicative of our results had we been a separate stand-alone entity during the periods presented, nor are the results stated herein indicative of what our financial position, results of operations, comprehensive earnings, and cash flows may be in the future.

Cash and cash equivalents held by Varian were not allocated to us. Cash and cash equivalents included in the condensed consolidated balance sheets primarily reflects cash and cash equivalents from acquired entities that are specifically attributable to us. Varian's debt has not been allocated to us for any of the periods presented since we not the legal obligor of the debt. Varian's debt was utilized for corporate activities that benefited all businesses and therefore a portion of the interest expense relating to Varian's corporate borrowings has been allocated to us for periods prior to the separation. Interest expense and interest income has been allocated based on our total assets as a percentage of total assets of Varian.

Critical Accounting Policies and Estimates

The preparation of our condensed consolidated financial statements and related disclosures in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and assumptions are based on historical experience and on various other factors that we believe are reasonable under the circumstances. Our critical accounting policies that are affected by accounting estimates require us to use judgments, often as a result of the need to make estimates and assumptions regarding matters that are inherently uncertain, and actual results could differ materially from these estimates.

We periodically review our accounting policies, estimates and assumptions and make adjustments when facts and circumstances dictate. Refer to Annual Report on Form 10-K for the fiscal year ended 2017 filed with the SEC on December 13, 2017, our Form 10 filed January 20, 2017 for fiscal years 2016, 2015, and 2014, and Note 3 "Summary of Significant Accounting Policies" for further details.

Fiscal Year

Our fiscal year is a 52 or 53-week period ending on the Friday nearest September 30. Fiscal year 2018 is the 52-week period ending September 28, 2018. Fiscal year 2017 was a 52-week period that ended on September 29, 2017. The fiscal quarters ended December 29, 2017 and December 30, 2016 were both 13-week periods.

Discussion of Results of Operations for the Three Months Ended December 29, 2017 Compared to the Three Months Ended December 30, 2016

Revenues

(In millions)	Three Months Ended		\$ Change	% Change
	December 29, 2017	December 30, 2016		
Medical	\$ 139.2	\$ 131.7	\$ 7.5	5.7%
Industrial	37.0	25.7	11.3	44.0%
Total revenues	<u>\$ 176.2</u>	<u>\$ 157.4</u>	<u>\$ 18.8</u>	<u>11.9%</u>
<i>Medical as a percentage of total revenues</i>	<i>79%</i>	<i>84%</i>		
<i>Industrial as a percentage of total revenues</i>	<i>21%</i>	<i>16%</i>		

Medical revenues increased by \$7.5 million primarily due to an increase in sales of digital detectors with the addition of the Acquired Detector Business, and from increased sales of software and high voltage cable products. These increases in medical revenues were partially offset by a decrease in sales of digital detectors for the dental and radiographic markets.

Industrial revenues increased \$11.3 million due to increased sales of digital detectors with the addition of the Acquired Detector Business, partially offset by a decrease of sales of cargo screening systems.

Gross Margin

(In millions)	Three Months Ended		\$ Change	% Change
	December 29, 2017	December 30, 2016		
Medical	\$ 46.4	\$ 47.1	\$ (0.7)	(1.5)%
Industrial	15.1	11.7	3.4	29.1 %
Total gross margin	\$ 61.5	\$ 58.8	\$ 2.7	4.6 %
Medical gross margin %	33.3%	35.8%		
Industrial gross margin %	40.8%	45.5%		
Total gross margin %	34.9%	37.4%		

The decrease in total gross margin percentage was primarily due to higher amortization of intangible assets from the Acquired Detector Business, a product mix shift to lower margin products and other indirect product related costs. The decrease in medical gross margin percentage was primarily due to the reasons stated above and the decrease in industrial gross margin percentage was primarily due to indirect product related costs.

Operating Expenses

(In millions)	Three Months Ended		\$ Change	% Change
	December 29, 2017	December 30, 2016		
Research and development	\$ 19.7	\$ 13.3	\$ 6.4	48.1%
As a percentage of total revenues	11.2%	8.4%		
Selling, general and administrative ⁽¹⁾	\$ 28.2	\$ 26.9	\$ 1.3	4.8%
As a percentage of total revenues	16.0%	17.1%		
Operating expenses	\$ 47.9	\$ 40.2	\$ 7.7	19.2%
As a percentage of total revenues	27.2%	25.5%		

(1) Selling, general and administrative expenses included \$11.9 million of corporate costs allocated to us by Varian in the three months ended December 30, 2016.

Research and Development

We are committed to investing in the business to support long-term growth and believe long-term research and development expenses of approximately 8% to 10% of annual revenues is the appropriate range that will allow us to continue to innovate and bring new products to market for our global OEM customers. The increase in research and development expenses as a percentage of revenue was due to the continued acceleration and development of digital detector projects and prototype materials costs for CT X-ray tubes.

Selling, General and Administrative

Selling, general and administrative expenses as a percentage of total revenues decreased primarily from lower acquisition and integration related costs, partially offset by increased depreciation, and amortization of intangible assets.

Interest and Other Income (Expense), Net

The following table summarizes the Company's interest and other income (expense), net:

(In millions)	Three Months Ended		\$ Change
	December 29, 2017	December 30, 2016	
Interest income	\$ 0.1	\$ 0.1	\$ —
Interest expense	(5.5)	(0.6)	(4.9)
Other	(1.1)	0.2	(1.3)
Interest and other income (expense), net	\$ (6.5)	\$ (0.3)	\$ (6.2)

The increase in interest and other income (expense), net was due to higher interest expense as a result of borrowings under our credit agreement, losses from equity method investments and foreign currency translation losses.

Taxes on Earnings

	Three Months Ended	
	December 29, 2017	December 30, 2016
Estimated effective tax rate	(60.6)%	38.8%

We had an income tax benefit of \$4.3 million and expense of \$7.1 million for the three months ended December 29, 2017 and December 30, 2016, respectively, for effective rates of (60.6)% and 38.8%, respectively.

Our effective tax rate decreased primarily due to the enactment of the Tax Reform Act in the U.S. during the period. The Tax Reform Act significantly revised the U.S. corporate income tax structure. Among the revisions impacting our effective tax rate are a lower U.S. corporate statutory tax rate going from 35% to 21% effective January 1, 2018, a repeal of the deduction for domestic production activities, and changes to the way foreign earnings are taxed. As a September fiscal year filer, the lower corporate income tax rate will be phased in resulting in an estimated U.S. statutory federal rate of 24.5% for the fiscal year ending September 28, 2018. U.S. GAAP requires the impact of tax legislation to be recognized in the period in which the law is enacted. The lower U.S. statutory rate has been included in the estimated annual effective rate used to calculate the year-to-date income tax benefit as of the end of the quarter. The repeal of the deduction for domestic production does not apply until the fiscal year beginning September 29, 2018 and so has also been included in the calculation of the estimated annual effective rate. Also, as a result of the Tax Reform Act, we recorded income tax expense of \$3.4 million for the tax on the deemed repatriation of deferred foreign earnings offset by a tax benefit of \$9.5 million due to the revaluation of net deferred taxes. The \$3.4 million of tax on the deemed repatriation of foreign earnings has been reduced by the utilization of an estimated foreign tax credit carryforward from the prior fiscal year which was previously subject to a full valuation allowance. The anticipated utilization of this deferred tax asset resulted in the release of that valuation allowance and the benefit of approximately \$1.9 million has been included in the income tax benefit for the quarter.

The changes included in the Tax Reform Act are broad, complex, and subject to interpretation. In addition, the calculation of the impact of certain provisions is dependent on amounts such as current year earnings and year end balances that, while they can be reasonably estimated, will only become final at the end of future accounting periods. On December 22, 2017, the SEC issued guidance under Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB 118”) allowing registrants to consider the estimated impact of the U.S. legislation as “provisional” when it does not have the information necessary to complete the accounting for the change in tax law. In accordance with SAB 118, the tax on the deemed repatriation of foreign earnings of \$3.4 million and the benefit of \$9.5 million for the revaluation of net deferred taxes represent the Company’s best and reasonable estimates based on interpretation of the U.S. legislation, are considered provisional, and will be finalized in future periods but no later than December 22, 2018. These provisional estimates may be revised as adjustments to tax expense in subsequent periods as actual amounts required to finalize the accounting for these items become final, as other required information becomes available, and as additional guidance is issued by regulatory bodies.

Certain other provisions included in the Tax Reform Act have later effective dates for fiscal year filers and may have an impact on the Company’s future effective tax rate. These include, but are not limited to, changes in the taxation of foreign earnings. The Company is in the process of analyzing the effects of these provisions including GILTI (global intangible low-taxed income), BEAT (base-erosion anti-abuse tax), FDII (foreign-derived intangible income), limitations on interest expense deductions (if certain conditions apply), and other components of the Tax Reform Act. The Company has elected to account for GILTI as a period cost if and when incurred pursuant to the exposure draft issued by the FASB in January 2018. Other future adjustments to tax expense may include the impact of actions the Company may take as a result of the Tax Reform Act.

Backlog

Backlog is the accumulation of all orders for which revenues have not been recognized and are still considered valid. Backlog also includes a small portion of billed service contracts that are included in deferred revenue. Our total backlog at December 29, 2017 was \$193.3 million, a decrease of 22.2% from \$248.4 million at September 29, 2017, which was primarily due to several of our customers providing quarterly orders rather than annual orders.

Orders may be revised or canceled, either according to their terms or as customers’ needs change. Consequently, it is difficult to predict with certainty the amount of backlog that will result in revenues. We perform a quarterly review to verify that outstanding orders in the backlog remain valid. Aged orders that are not expected to be converted to revenues are deemed dormant and are reflected as a reduction in the backlog amounts in the period identified.

Liquidity and Capital Resources

We assess our liquidity in terms of our ability to generate cash to fund our operating and investing activities. We continue to generate substantial cash from operating activities and believe that our operating cash flow, credit facility, and other sources of liquidity will be sufficient to allow us to continue to invest in our existing businesses, consummate strategic acquisitions and manage our capital structure on a short and long-term basis. Although we believe that our future cash from operations, together with our access to banking and capital markets, will provide adequate resources to fund our operating and financing needs, our access to, and the availability of, financing on acceptable terms in the future will be affected by many factors, including: (i) the liquidity of the overall capital markets and (ii) the current state of the economy. There can be no assurances that we will continue to have access to these markets on terms acceptable to us.

Cash and Cash Equivalents

The following table summarizes our cash and cash equivalents:

(In millions)	December 29, 2017	September 29, 2017	\$ Change
Cash and cash equivalents	\$ 94.1	\$ 83.3	\$ 10.8

Borrowings

The following table summarizes the changes in our debt outstanding:

(Dollars in millions)	December 29, 2017	September 29, 2017	\$ Change
Current portion of Term Facility	\$ 20.0	\$ 20.0	\$ —
Revolving Credit Facility	79.0	104.0	(25.0)
Long-Term portion of Term Facility	365.0	370.0	(5.0)
Debt issuance costs	(9.5)	(10.1)	0.6
Total debt outstanding	\$ 454.5	\$ 483.9	\$ (29.4)

At December 29, 2017, we had approximately \$121 million remaining of our Revolver available for borrowings.

Cash Flows

(In millions)	Three Months Ended	
	December 29, 2017	December 30, 2016
Net cash flow provided by (used in):		
Operating activities	\$ 40.1	\$ 19.2
Investing activities	(2.6)	(4.3)
Financing activities	(26.8)	1.8
Effects of exchange rate changes on cash and cash equivalents	0.1	0.7
Net increase in cash and cash equivalents	\$ 10.8	\$ 17.4

Net Cash Provided by Operating Activities. Cash from operating activities consists primarily of net earnings adjusted for certain non-cash items, including share-based compensation, depreciation, amortization of intangible assets, deferred income taxes, income and loss from equity investments and the effect of changes in operating assets and liabilities.

For the three months ended December 29, 2017, as compared to the three months ended December 30, 2016, cash provided by operating activities were as follows:

- Net earnings of \$11.4 million vs \$11.2 million
- Non-cash items of \$2.6 million vs \$12.0 million
- Operating assets and liabilities activity:
 - Accounts receivable decreased \$33.6 million vs \$9.9 million. The fourth quarter of fiscal year 2017 had a higher level of sales and resulted in increased collections of accounts receivable in the first quarter of fiscal year 2018.

- Inventories increased \$9.6 million vs \$6.7 million. Increases in inventories in the first quarter of each fiscal year is normal as we begin to right-size our inventories for the upcoming quarters.

- Other items increased \$2.1 million vs decreases of \$7.2 million. These items include changes in prepaid expenses, accounts payable, accrued liabilities, deferred revenues, which fluctuate due to timing of expenses and payments.

Net Cash Used in Investing Activities. Net cash used in investing activities was \$2.6 million and \$4.3 million for the three months ended December 29, 2017 and the three months ended December 30, 2016, respectively, and primarily related to capital expenditures for property plant and equipment for both periods.

Net Cash Provided by (Used in) Financing Activities. Financing activities for the three months ended December 29, 2017 consisted of borrowings under our credit agreement of \$2.0 million, repayments of borrowings of \$32.0 million, proceeds from stock option exercises of \$1.8 million, and proceeds from shares issued under employee stock purchase plan. Financing activities for the three months ended December 30, 2016 consisted of transfers from Varian of \$1.8 million.

Days Sales Outstanding

Trade accounts receivable days sales outstanding (“DSO”) was 67 days at December 29, 2017 and 66 days September 29, 2017. Our accounts receivable and DSO are impacted by a number of factors, primarily including the timing of product shipments, collections performance, payment terms, the mix of revenues from different regions and the effects of economic instability.

Contractual Obligations

In October 2013, we entered into an amended agreement with dpiX and other parties that, among other things, provides us with the right to 50% of dpiX’s total manufacturing capacity produced after January 1, 2014. The amended agreement requires us to pay for 50% of the fixed costs (as defined in the amended agreement), as determined at the beginning of each calendar year. As of December 29, 2017, we do not yet have a fixed cost commitment related to this amended agreement. In January 2018, the fixed costs commitment was determined and approved by the dpiX board of directors to be \$16.3 million for calendar year 2018. The amended agreement will continue unless the ownership structure of dpiX changes (as defined in the amended agreement).

In October 2015, we committed to grant the noncontrolling shareholders of MeVis: (1) an annual recurring net compensation of €0.95 per MeVis share; and, (2) a put right for their MeVis shares at €19.77 per MeVis share. As of December 29, 2017, noncontrolling shareholders together held approximately 0.5 million shares of MeVis, representing 26.3% of the outstanding shares.

Contingencies

From time to time, we are a party to or otherwise involved in legal proceedings, claims and government inspections or investigations and other legal matters both inside and outside the United States, arising in the ordinary course of our business or otherwise. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. See Note 11 “Commitments and Contingencies” in the notes to the condensed consolidated financial statements, which discussion is incorporated herein by reference.

Off-Balance Sheet Arrangements

In conjunction with the sale of our products in the ordinary course of business, we provide standard indemnification of business partners and customers for losses suffered or incurred for property damages, death and injury and for patent, copyright or any other intellectual property infringement claims by any third parties with respect to our products. The terms of these indemnification arrangements are generally perpetual. Except for losses related to property damages, the maximum potential amount of future payments we could be required to make under these arrangements is unlimited. As of December 29, 2017, we have not incurred any material costs to defend lawsuits or settle claims related to these indemnification arrangements. As a result, we believe the estimated fair value of these arrangements is minimal.

We have indemnification obligations to our directors and officers and certain of our employees that serve as officers or directors of our foreign subsidiaries that may require us to indemnify our directors and officers and those certain employees against liabilities that may arise by reason of their status or service as directors or officers, and to advance their expenses incurred as a result of any legal proceeding against them as to which they could be indemnified.

Recent Accounting Standards or Updates Not Yet Effective

See Note 3, “Summary of Significant Accounting Policies” of the notes to the condensed consolidated financial statements for a description of recent accounting standards, including the expected dates of adoption and the estimated effects on our consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risks

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

Foreign Currency Exchange Rate Risk

A significant portion of our customers are outside the United States and our products are generally priced in U.S. Dollars. A strong U.S. Dollar may result in pricing pressure for our customers that are located outside the United States and that conduct their businesses in currencies other than the U.S. Dollar. In addition, because our business is global and some payments may be made in local currency, fluctuations in foreign currency exchange rates can impact our revenues and expenses and/or the profitability in U.S. Dollars of products and services that we provide in foreign markets.

Credit and Counterparty Risk

We use a centralized approach to manage substantially all of our cash and to finance our operations. Our cash and cash equivalents may be exposed to a concentration of credit risk and we may also be exposed to credit risk and interest rate risk to the extent that we enter into credit facilities.

We perform ongoing credit evaluations of our customers and we maintain strong credit controls in evaluating and granting customer credit, including performing ongoing evaluations of our customers’ financial condition and creditworthiness and often using letters of credit and requiring industrial customers to provide a down payment.

Interest Rate Risk

At December 29, 2017, we had borrowings of \$454.5 million. Borrowings under our credit facilities bear interest at floating interest rates. As a result, we are exposed to fluctuations in interest rates to the extent of our borrowings under the credit facilities. As part of our overall risk management program, we entered into several interest rate swaps designed as cash flow hedges, to hedge the floating LIBOR components of our interest rate which represented a notional value of \$288.8 million of our debt as of December 29, 2017. See Note 7, “Financial Derivatives and Hedging Activities” for further information on hedging activities.

Commodity Price Risk

We are exposed to market risks related to volatility in the prices of raw materials used in our products. The prices of these raw materials fluctuate in response to changes in supply and demand fundamentals and our product margins and level of profitability tend to fluctuate with changes in these raw materials prices. We try to protect against such volatility through various business strategies. During the three months ended December 29, 2017, we did not have any commodity derivative instruments in place to manage our exposure to price changes.

Item 4. Controls and Procedures

Based on the evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e)) under the Securities Exchange Act of 1934), as amended (the “Exchange Act”) required by Rules 13a-15(b) or 15d-15(b) under the Exchange Act, our Chief Executive Officer and our Chief Financial Officer have concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective.

Changes in internal control over financial reporting

There were no changes in our internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

We are subject to various claims, complaints and legal actions in the normal course of business from time to time. We do not believe we have any currently pending litigation for which the outcome could have a material adverse effect on our operations or financial position.

Item 1A. Risk Factors

We operate in a rapidly changing environment that involves a number of risks that could materially and adversely affect our business. For a detailed discussion of the risks that affect our business, please refer to the section entitled "Risk Factors" in our Annual Report on Form 10-K for the year ended September 29, 2017 filed with the SEC on December 13, 2017. In addition, the following risk factors should be considered in conjunction with those risk factors previously reported.

United States Tax Reform

The Tax Cuts and Jobs Act of 2017 was signed into law on December 22, 2017. The law includes significant changes to the U.S. corporate income tax system, including a Federal corporate rate reduction from 35% to 21%, limitations on the deductibility of interest expense and executive compensation, and extensive changes to the way foreign earnings are taxed in the U.S. The new tax law could impact our tax liabilities in a number of ways, including causing us to incur a tax liability on earnings that have not been repatriated into the United States and limiting our ability to deduct the expense of certain executive compensation. In addition, significant judgments and estimates are required to evaluate our tax position and the impact of the new tax law. If these judgments and estimates are incorrect, or if the underlying assumptions are different from what we expect, our tax liability could differ significantly from our current estimates. The new tax law could also impact the financial condition of our customers, which could cause those customers to decrease the amount of products they purchase from us, which would adversely affect our operating results.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

(a) Exhibits required to be filed by Item 601 of Regulation S-K:

Exhibit No.	Description
<u>10.1*</u>	<u>Amendment to Credit Agreement</u>
<u>31.1*</u>	<u>Chief Executive Officer Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act</u>
<u>31.2*</u>	<u>Chief Financial Officer Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act</u>
<u>32.1*</u>	<u>Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
<u>32.2*</u>	<u>Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.

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.

VAREX IMAGING CORPORATION

Date: February 6, 2018

By: /s/ CLARENCE R. VERHOEF

Clarence R. Verhoef

Senior Vice President and Chief Financial Officer

(Duly Authorized Officer and Principal Financial Officer)