Nuance Communications, Inc.
Form 10-Q
August 09, 2010

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

Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2010

Or

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

Commission file number 0-27038

NUANCE COMMUNICATIONS, INC.
(Exact name of registrant as specified in its charter)

Delaware	**94-3156479**
(State or Other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
1 Wayside Road Burlington, Massachusetts	**01803**
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code:
(781) 565-5000

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 þ No o

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 þ No o

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of the Registrant s Common Stock, outstanding as of July 31, 2010, was 293,896,196.

NUANCE COMMUNICATIONS, INC.

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NUANCE COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
	(Unaudited) (In thousands, except per share amounts)			
Revenue:				
Product and licensing	$ 108,840	$ 87,387	$ 335,228	$ 259,987
Professional services and hosting	117,875	110,966	337,798	304,162
Maintenance and support	46,488	42,687	136,159	122,870
Total revenue	273,203	241,040	809,185	687,019
Cost of revenue:				
Product and licensing	10,901	8,414	34,194	26,222
Professional services and hosting	71,353	68,321	206,349	189,584
Maintenance and support	7,631	7,207	23,335	21,387
Amortization of intangible assets	11,893	10,017	35,095	27,444
Total cost of revenue	101,778	93,959	298,973	264,637
Gross profit	171,425	147,081	510,212	422,382
Operating expenses:				
Research and development	38,916	27,742	113,797	85,622
Sales and marketing	67,219	50,233	196,680	160,850
General and administrative	29,887	24,507	88,643	75,333
Amortization of intangible assets	21,459	19,931	65,786	56,313
Acquisition-related costs, net	6,125	4,659	26,892	13,889
Restructuring and other charges, net	3,257	2,893	16,244	5,241
Total operating expenses	166,863	129,965	508,042	397,248
Income from operations	4,562	17,116	2,170	25,134
Other income (expense):				
Interest income	171	683	780	3,152
Interest expense	(9,971)	(10,137)	(30,380)	(36,827)
Other income (expense), net	5,539	(3,807)	10,685	1,971
Income (loss) before income taxes	301	3,855	(16,745)	(6,570)
Provision for income taxes	1,831	6,670	4,459	17,283
Net loss	$ (1,530)	$ (2,815)	$ (21,204)	$ (23,853)

Net loss per share:				
Basic	$ (0.01)	$ (0.01)	$ (0.07)	$ (0.10)
Diluted	$ (0.01)	$ (0.01)	$ (0.07)	$ (0.10)
Weighted average common shares outstanding:				
Basic	291,610	260,750	285,202	249,105
Diluted	291,610	260,750	285,202	249,105

See accompanying notes. Financial statements as of September 30, 2009 and for the three and nine months ended June 30, 2009 have been adjusted for the retrospective application of FASB ASC 470-20 (see Notes 2 and 12)

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NUANCE COMMUNICATIONS, INC.

CONSOLIDATED BALANCE SHEETS

	June 30, 2010 (Unaudited)	September 30, 2009
	(In thousands, except per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 492,074	$ 527,038
Restricted cash (Note 9)	21,974	
Accounts receivable, less allowances for doubtful accounts of $6,923 and $6,833	216,049	199,548
Acquired unbilled accounts receivable	6,462	9,171
Inventories, net	8,323	8,525
Prepaid expenses and other current assets	52,553	51,545
Total current assets	797,435	795,827
Land, building and equipment, net	56,372	53,468
Goodwill	2,041,590	1,891,003
Intangible assets, net	667,879	706,805
Other assets	67,628	52,361
Total assets	$ 3,630,904	$ 3,499,464
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt and capital leases	$ 8,209	$ 6,862
Contingent and deferred acquisition payments	2,093	91,431
Accounts payable	68,521	59,574
Accrued expenses and other current liabilities	138,538	104,819
Accrued business combination costs	9,574	12,144
Deferred maintenance revenue	87,395	84,607
Unearned revenue	51,701	59,788
Total current liabilities	366,031	419,225
Long-term portion of debt and capital leases	850,400	848,898
Long-term portion of accrued business combination costs	17,081	24,904
Deferred revenue, net of current portion	67,197	33,904
Deferred tax liability	53,117	56,346
Other liabilities	81,897	73,186
Total liabilities	1,435,723	1,456,463
Commitments and contingencies (Notes 2, 5 and 17)		

Stockholders equity:		
Series B preferred stock, $0.001 par value; 15,000 shares authorized; 3,562 shares issued and outstanding (liquidation preference $4,631)	4,631	4,631
Common stock, $0.001 par value; 560,000 shares authorized; 297,123 and 280,647 shares issued and 293,372 and 276,935 shares outstanding	297	281
Additional paid-in capital	2,512,218	2,308,992
Treasury stock, at cost (3,751 and 3,712 shares)	(16,789)	(16,214)
Accumulated other comprehensive income (loss)	(21,716)	7,567
Accumulated deficit	(283,460)	(262,256)
Total stockholders equity	2,195,181	2,043,001
Total liabilities and stockholders equity	$ 3,630,904	$ 3,499,464

See accompanying notes. Financial statements as of September 30, 2009 and for the three and nine months ended June 30, 2009 have been adjusted for the retrospective application of FASB ASC 470-20 (see Notes 2 and 12).

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NUANCE COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended June 30,	
	2010	2009
	(Unaudited) (In thousands)	
Cash flows from operating activities:		
Net loss	$ (21,204)	$ (23,853)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation of property and equipment	15,857	13,641
Amortization of intangible assets	100,881	83,757
Stock-based compensation	72,868	52,584
Non-cash interest expense	9,746	9,330
Non-cash restructuring expense	6,833	
Bad debt provision	994	1,564
Gain on foreign currency forward contracts		(8,049)
Deferred tax provision	(2,321)	8,117
Other	677	61
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	(13,023)	47,713
Inventories	280	(2,261)
Prepaid expenses and other assets	(5,149)	(5,746)
Accounts payable	(3,960)	22,744
Accrued expenses and other liabilities	(7,825)	(9,217)
Deferred revenue	30,044	(6,124)
Net cash provided by operating activities	184,698	184,261
Cash flows from investing activities:		
Capital expenditures	(16,284)	(15,682)
Payments for acquisitions, net of cash acquired	(155,882)	(113,886)
Proceeds from maturities of marketable securities		56
Payments for equity investment	(14,970)	(159)
Payments for acquired technology	(14,850)	(65,257)
Increase in restricted cash (Note 9)	(22,070)	
Net cash used in investing activities	(224,056)	(194,928)
Cash flows from financing activities:		
Payments of debt and capital leases	(6,376)	(5,261)
Purchases of treasury stock	(575)	(144)
Payments of other long-term liabilities	(7,319)	(6,915)
Proceeds from settlement of share-based derivatives	6,391	
Proceeds from issuance of common stock, net of issuance costs	12,350	175,111

Proceeds from issuance of common stock from employee stock options and purchase plan	22,832	10,996
Cash used to net share settle employee equity awards	(17,465)	(6,187)
Net cash provided by financing activities	9,838	167,600
Effects of exchange rate changes on cash and cash equivalents	(5,444)	114
Net increase (decrease) in cash and cash equivalents	(34,964)	157,047
Cash and cash equivalents at beginning of period	527,038	261,540
Cash and cash equivalents at end of period	$ 492,074	$ 418,587

See accompanying notes. Financial statements as of September 30, 2009 and for the three and nine months ended June 30, 2009 have been adjusted for the retrospective application of FASB ASC 470-20 (see Notes 2 and 12).

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Presentation

The consolidated financial statements include the accounts of Nuance Communications, Inc. (Nuance , we , or the Company) and our wholly-owned subsidiaries. We prepared these unaudited interim consolidated financial statements in accordance with U.S. generally accepted accounting principles (GAAP) for interim periods. In our opinion, these financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of our financial position for the periods disclosed. Intercompany transactions have been eliminated.

We acquired SpinVox Limited (SpinVox), a UK-based privately-held company engaged in the business of providing voice to text services, on December 30, 2009 and other businesses during the second and third quarters of 2010. Refer to Note 4 for additional information.

Although we believe the disclosures in these financial statements are adequate to make the information presented not misleading, certain information normally included in the footnotes prepared in accordance with GAAP has been omitted. Accordingly, these financial statements should be read in conjunction with the audited financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2009. Interim results are not necessarily indicative of the results that may be expected for a full year.

We reclassified certain acquisition-related costs included within operating expenses for the three and nine months ended June 30, 2009 to conform to our revised statement of operations presentation for such costs as disclosed in Note 2 below. Such reclassifications had no impact on earnings or cash flows provided by operations.

2. Summary of Significant Accounting Policies

We have made no material changes to the significant accounting policies disclosed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2009, other than as outlined below.

Acquisition-Related Costs, net

Acquisition-related costs include those costs related to business and other acquisitions, including potential acquisitions. These costs consist of transition and integration costs, including retention payments, transitional employee costs and earn-out payments treated as compensation expense, as well as the costs of integration-related services provided by third-parties; professional service fees, including direct third-party costs of the transaction and post-acquisition legal and other professional service fees associated with disputes and regulatory matters related to acquired entities; and adjustments to acquisition-related items that are required to be marked to fair value each reporting period, such as contingent consideration, and other items related to acquisitions for which the measurement period has ended. Previous to our adoption of ASC 805, *Business Combinations* (formerly referred to as SFAS No. 141 (revised), *Business Combinations* (SFAS 141R) in fiscal 2010, certain acquisition-related costs and adjustments now recorded as operating expenses in our consolidated statements of operations were included as a part of the consideration transferred and capitalized as a part of the accounting for our business acquisitions pursuant to previous accounting rules, primarily direct transaction costs. In addition, there were no items under the legacy business combination accounting guidance that were required to be re-measured to fair value on a recurring basis.

	Three Months Ended	Nine Months Ended

	June 30,		June 30	
	2010	2009	2010	2009
Transition and integration costs	$ 3,383	$ 1,243	$ 12,035	$ 3,149
Professional service fees	3,079	3,361	14,933	11,389
Acquisition-related adjustments	(337)	55	(76)	(649)
Total	$ 6,125	$ 4,659	$ 26,892	$ 13,889

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accounting for Collaboration Agreements

On October 9, 2009, we entered into a five-year collaboration agreement with a third party to accelerate the development of new speech technologies. All intellectual property derived from the collaboration will be jointly-owned by the two parties and Nuance will have the sole rights to commercialize the intellectual property during the term of the agreement. In consideration for the services from the third party in the collaboration efforts, as well as the joint ownership rights over intellectual property developed under the arrangement and the exclusive right to commercialize such developed intellectual property for the term of the arrangement, we will pay $80.0 million in five equal payments of $16.0 million on August 15th of each year, payable in cash or our common stock, at our option. These upfront payments will be recorded as a prepaid asset and expensed ratably over each annual period, commensurate with the pattern in which we expect the third party to perform its services and convey our rights under the arrangement. On October 14, 2009, we made our first payment under the arrangement consisting of 1,047,120 shares of our common stock valued at $16.0 million. For the three and nine months ended June 30, 2010, $4.0 million and $12.0 million, respectively have been recorded as research and development expense in our consolidated statements of operations.

On January 13, 2010, we amended the collaboration agreement to extend certain provisions for eighteen months following the termination of the agreement. In consideration for the extension, we agreed to pay an additional $12.0 million to the third-party in five equal payments of $2.4 million on August 15th of each year over the five-year agreement term, payable in cash or our common stock, at our option, with the exception of the first payment, which was made during the second quarter of fiscal 2010 through the issuance of 145,897 shares of our common stock. These upfront payments are recorded as a prepaid asset when made and will be expensed ratably to sales and marketing expense over the eighteen-month extension period.

Accounting for Convertible Debt

During the first quarter of fiscal 2010, we adopted the provisions in FASB ASC 470-20 as they relate to our convertible debt instruments that may be settled in cash upon conversion (formerly referred to as FSP APB 14-1, *Accounting for Convertible Debt Instruments that May be Settled in Cash upon Conversion (Including Partial Cash Settlement)*) effective October 1, 2009. The guidance requires us to separately account for the liability (debt) and equity (conversion option) components of our convertible debt instruments that require or permit settlement in cash upon conversion in a manner that reflects our nonconvertible debt borrowing rate at the time of issuance. The equity components of our convertible debt instruments are recorded to stockholders equity with an offsetting debt discount. The debt discount created is amortized to interest expense in our consolidated statement of operations using the effective interest method over the expected term of the convertible debt. The provisions herein discussed have been applied retrospectively to all financial information presented. Refer to information below and in Note 12 for further information.

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables illustrate the retrospective effect of adopting ASC 470-20 to the consolidated statements of operations for the three and nine months ended June 30, 2009 (in thousands):

	Three Months Ended June 30, 2009		Nine Months Ended June 30, 2009	
	As Originally Reported	As Adjusted for Retrospective Application	As Originally Reported	As Adjusted for Retrospective Application
Interest expense	$ 8,331	$ 10,137	$ 31,466	$ 36,827
Income (loss) before income taxes	5,661	3,855	(1,209)	(6,570)
Net loss	(1,009)	(2,815)	(18,492)	(23,853)
Net loss per share Basic and Diluted	$ (0.00)	$ (0.01)	$ (0.07)	$ (0.10)

The following table illustrates the retrospective effect of adopting ASC 470-20 to the consolidated balance sheet as of September 30, 2009 (in thousands):

	As Originally Reported	As Adjusted for Retrospective Application
Other assets(a)	$ 52,511	$ 52,361
Long-term portion of debt and capital leases(b)	888,611	848,898
Additional paid-in-capital(c)	2,254,511	2,308,992
Accumulated deficit	$ (247,338)	$ (262,256)

(a) Other assets have been adjusted for the portion of the debt issuance costs attributable to the 2.75% Convertible Senior Notes that must be retrospectively allocated to the equity component of the debt instrument through additional paid-in-capital as of the date of the notes issuance.

(b) Long-term portion of debt and capital leases has been adjusted to reflect retrospective recognition of the debt discount created by bifurcating the equity component of the convertible notes from the liability component.

(c) Additional paid-in-capital has been adjusted to reflect recording, retrospectively, the equity component of the convertible notes, as well as the equity component allocation of the debt issuance costs attributable to the 2.75% Convertible Senior Notes.

Recently Issued Accounting Standards

In April 2010, the FASB issued ASU No. 2010-17, *Revenue Recognition Milestone Method (Topic 605): Milestone Method of Revenue Recognition*. The ASU codifies the consensus reached in Emerging Issues Task Force (EITF) Issue No. 08-9, *Milestone Method of Revenue Recognition*. The amendments to the FASB Accounting Standards

Codification (the Codification or ASC) provide guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. Consideration that is contingent on achievement of a milestone in its entirety may be recognized as revenue in the period in which the milestone is achieved only if the milestone is judged to meet certain criteria to be considered substantive. The amendments in the ASU are effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010. Early adoption is permitted. If an entity elects early adoption and the period of adoption is not the beginning of the entity s fiscal year, the entity must apply the amendments retrospectively from the beginning of the year of adoption. Entities may also elect to adopt the amendments in the ASU retrospectively for all prior periods. We are currently evaluating the potential impact of this ASU on our consolidated financial statements.

In January 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-06, *Improving Disclosures about Fair Value Measurements (Topic 820) Fair Value Measurements and Disclosures* (ASU 2010-06) to add

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

additional disclosures about the different classes of assets and liabilities measured at fair value, the valuation techniques and inputs used, the activity in Level 3 fair value measurements, and transfers between Levels 1, 2, and 3. Levels 1, 2 and 3 of fair value measurements are defined in Note 8 below. ASU 2010-06 was effective for us for the interim reporting period beginning January 1, 2010, except for the provisions related to activity in Level 3 fair value measurements. Those provisions are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. ASU 2010-06 impacts disclosure only and therefore, did not, and is not expected to, have a material impact on our financial statements.

In September 2009, the EITF ratified EITF Issue No. 08-1, *Revenue Arrangements with Multiple Deliverables*, which has since been codified in the ASC as ASU No. 2009-13 (ASU 2009-13), supersedes EITF Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*, now referred to as ASC 605-25-50-1. ASU 2009-13 eliminates the residual method of accounting for non-software arrangements, as well as the associated requirements for establishing objective and reliable evidence of fair value. The residual method is replaced in ASU 2009-13 by the estimated selling price method whereby revenue in a multiple-element arrangement is allocated to each element based on its estimated selling price. Estimating selling price is established through a hierarchy starting with vendor-specific objective evidence of fair value, followed by third-party evidence, and lastly by any reasonable, objective estimate of the selling price were the element to be sold on a standalone basis. Estimates of selling price must consider both entity-specific factors and market conditions. ASU 2009-13 is applied prospectively to all revenue transactions entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted if adopted as of the beginning of an entity s fiscal year and no prior interim period financial statements from that fiscal year have already been issued or the entity retrospectively applies the provisions of this ASU to its previously-issued current fiscal year interim financial statements. We currently do not expect that the adoption of ASU 2009-13 will have a material impact on our consolidated financial statements.

In September 2009, the EITF ratified EITF Issue No. 09-3, *Applicability of AICPA Statement of Position 97-2 to Certain Arrangements That Include Software Elements*, which has since been codified in the Codification as ASU No. 2009-14 (ASU 2009-14). ASU 2009-14 applies to multiple-element arrangements that contain both software and hardware elements, and amends the scope of AICPA Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, now referred to as ASC 985-605, to exclude tangible products containing software and non-software components that together function to deliver the product s essential functionality from the scope of ASC 985-605. ASU 2009-14 is applied prospectively to all revenue transactions entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted only when ASU 2009-13 is also early adopted as of the same period. We are continuing to evaluate the potential impact of this ASU on our consolidated financial statements.

3. Comprehensive Income (Loss)

The components of comprehensive income (loss) are as follows (table in thousands):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	**2009**	**2010**	**2009**
Net loss	$ (1,530)	$ (2,815)	$ (21,204)	$ (23,853)

Other comprehensive income (loss):				
Foreign currency translation adjustment	(19,488)	15,786	(31,510)	(10,232)
Unrealized gain (loss) on cash flow hedge derivatives	690	1,434	2,228	(2,795)
Total comprehensive income (loss)	$ (20,328)	$ 14,405	$ (50,486)	$ (36,880)

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Business Acquisitions

Acquisition of SpinVox

On December 30, 2009, we acquired all of the outstanding capital stock of SpinVox Limited (SpinVox), a UK-based privately-held company engaged in the business of providing voicemail-to-text services. The acquisition was a taxable stock purchase and the goodwill resulting from this acquisition is not expected to be deductible for tax purposes. The results of operations of SpinVox have been included in our results of operations from January 1, 2010. The results of operations of SpinVox for the one day, December 31, 2009, of the fiscal first quarter during which SpinVox was a part of Nuance were excluded from our consolidated results for the nine months ended June 30, 2010 as such amounts for that one day were immaterial.

A summary of the preliminary allocation of the purchase consideration is as follows (in thousands):

Total purchase consideration:	
Cash	$ 67,500
Common stock(a)	36,352
Total purchase consideration	$ 103,852
Allocation of the purchase consideration:	
Cash	$ 4,061
Accounts receivable(b)	11,140
Other assets	5,856
Property and equipment	1,585
Identifiable intangible assets	32,400
Goodwill	114,939
Total assets acquired	169,981
Current liabilities(c)	(65,077)
Deferred revenue	(1,052)
Total liabilities assumed	(66,129)
Net assets acquired	$ 103,852

(a) Approximately 2.3 million shares of our common stock, valued at $15.81 per share based on the closing price of our common stock on the acquisition date, were issued at closing.

(b) Accounts receivable have been recorded at their estimated fair value, which consists of the gross accounts receivable assumed of $16.6 million, reduced by fair value reserve of $5.5 million representing the portion of contractually owed accounts receivable which we do not expect to be collectible.

(c) Current liabilities include a commitment of EUR 25.0 million ($36.0 million based on the December 30, 2009 exchange rate) fixed obligation, payable in cash, in December 2010.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following are the identifiable intangible assets acquired and their respective weighted average useful lives, as determined based on a preliminary valuation (table in thousands, except for years):

	Amount	Weighted Average Life (Years)
Customer relationships	$ 23,400	12.0
Core and completed technology	8,400	4.7
Trade name	600	2.0
Total	$ 32,400	

Other Fiscal 2010 Acquisitions

During fiscal 2010, we acquired several businesses primarily to expand our product offerings and enhance our technology base. The results of operations of these companies have been included in our consolidated results from their respective acquisition dates. The total consideration for these acquisitions was $35.2 million, including the issuance of 1.2 million shares of our common stock valued at $21.8 million. In allocating the total purchase consideration for these acquisitions based on estimated fair values, we preliminarily recorded $21.5 million of goodwill and $13.8 million of identifiable intangible assets. The preliminary allocations of the purchase consideration were based upon preliminary valuations and our estimates and assumptions are subject to change. Intangible assets acquired included primarily core and completed technology and customer relationships with weighted average useful lives of 7.2 years. The acquisitions were primarily stock acquisitions and the goodwill resulting from these acquisitions is not expected to be deductible for tax purposes.

Pro Forma Results

The following unaudited pro forma financial information summarizes the combined results of operations for the Company and SpinVox as though they were combined from October 1, 2008 (table in thousands, except per share data):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Revenue	$ 273,203	$ 247,728	$ 821,161	$ 698,779
Net loss	(1,530)	(17,271)	(52,766)	(89,796)
Net loss per share basic and diluted	$ (0.01)	$ (0.07)	$ (0.18)	$ (0.36)

We have not furnished pro forma financial information relating to our other fiscal 2010 acquisitions because such information is not material, individually or in the aggregate, to our financial results.

5. Contingent Acquisition Payments

Earn-out Payments

In accordance with our adoption of ASC 805 in fiscal 2010, for business combinations occurring subsequent to the adoption date, the fair value of any contingent consideration will be established at the acquisition date and recorded as purchase price. The contingent consideration will then be adjusted to fair value each reporting period and such adjustment will be recorded as an increase or decrease in current earnings. Contingent consideration related to acquisitions prior to our adoption of ASC 805 have been and will continue to be recorded as additional purchase price when the contingency is resolved and additional consideration is attributable.

In connection with an immaterial acquisition during fiscal 2010, we agreed to make contingent earn-out payments of up to $2.5 million, payable in stock, upon the achievement of certain financial targets. At the

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

acquisition date, we recorded $1.0 million as contingent consideration. For the three and nine months ended June 30, 2010, we have recorded income of $0.4 million and $0.2 million, respectively, as fair value adjustments included in acquisition-related costs, net in our consolidated statement of operations.

In connection with our acquisition of SNAPin Software, Inc. (SNAPin), we agreed to make a contingent earn-out payment of up to $45.0 million in cash to be paid, if at all, based on the business achieving certain performance targets that are measurable from the acquisition date to December 31, 2009. In April 2010, the Company and the former shareholders of SNAPin agreed on a final earn-out payment of $21.2 million and issued 593,676 shares of our common stock, valued at $10.2 million, as our first payment under the earn-out agreement. The remaining balance is payable in cash or stock, solely at our option, on or before October 1, 2011 and is included in long-term liabilities as of June 30, 2010.

In connection with our acquisition of Multi-Vision Communications, Inc. (Multi-Vision), we agreed to make contingent earn-out payments of up to $15.0 million, payable in stock, or cash, solely at our discretion, relating to earn-out provisions described in the share purchase agreement. We have notified the former shareholders of Multi-Vision that the performance targets were not achieved. Through June 30, 2010, we have not recorded any obligation or related compensation expense relative to these measures.

In connection with our acquisition of Vocada, Inc. (Vocada), we agreed to make contingent earn-out payments of up to $21.0 million, payable in stock, or cash, solely at our discretion, upon the achievement of certain financial targets measured over defined periods through December 31, 2010. Earn-out payments, if any, will be recorded as incremental purchase price and allocated to goodwill. We have notified the former shareholders of Vocada that the financial targets for certain periods were not achieved and they have requested additional information regarding this determination. We are currently in discussions with the former shareholders of Vocada regarding this matter. Through June 30, 2010, we have not recorded any earn-out obligation relative to the Vocada acquisition.

In connection with the acquisition of Commissure, Inc. (Commissure), we agreed to make contingent earn-out payments of up to $8.0 million, payable in stock, or cash, solely at our discretion, upon the achievement of certain financial targets for the fiscal years 2008, 2009 and 2010. Earn-out payments, if any, will be recorded as incremental purchase price and allocated to goodwill. We have notified the former shareholders of Commissure that the financial targets for the fiscal years 2008 and 2009 were not achieved and the related contingent earn-out payment was not earned. Through June 30, 2010, we have not recorded any earn-out obligation relative to the Commissure acquisition.

In November 2008, we amended the earn-out provisions set forth in the merger agreement related to the acquisition of Mobile Voice Control, Inc. (MVC) such that the former shareholders of MVC were eligible to earn 377,964 and 755,929 shares based on the achievement of calendar 2008 and 2009 financial targets, respectively. Earn-out payments, if any, will be recorded as incremental purchase price and allocated to goodwill. We have notified the former shareholders of MVC that the financial targets for calendar 2008 and 2009 were not achieved and therefore we have not recorded any obligation relative to these measures.

In connection with our acquisition of Phonetic Systems Ltd. (Phonetic) in February 2005, we agreed to make contingent earn-out payments of $35.0 million upon achievement of certain established financial and performance targets, in accordance with the merger agreement. In December 2009, we paid $11.3 million to the former shareholders of Phonetic in final settlement of the contingent earn-out provisions; recording the amount paid as additional purchase price related to the Phonetic acquisition.

Escrow and Holdback Arrangements

In connection with certain of our acquisitions, we have placed either cash or shares of our common stock in escrow to satisfy any claims we may have. If no claims are made, the escrowed amounts will be released to the former shareholders of the acquired companies. Historically, under the previous accounting guidance of

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SFAS No. 141, *Business Combinations* (SFAS 141), we could not make a determination, beyond a reasonable doubt, whether the escrow would become payable to the former shareholders of these companies until the escrow period had expired. Accordingly, these amounts were treated as contingent purchase price until it was determined that the escrow was payable, at which time the escrowed amounts would be recorded as additional purchase price and allocated to goodwill. Under the revised accounting guidance of ASC 805, escrow payments are generally considered part of the initial purchase consideration and accounted for as goodwill.

The following table summarizes the terms of the escrow arrangements that were entered into under the guidance of SFAS 141 that were not released as of June 30, 2010 (table in thousands):

	Initially Scheduled Escrow Release Date	Cash Payment
X-Solutions Group B.V.	December 10, 2010	$ 1,050
eCopy, Inc.	December 30, 2010	4,100
Total		$ 5,150

6. Goodwill and Intangible Assets

The changes in the carrying amount of goodwill for the nine months ended June 30, 2010, are as follows (in thousands):

Balance as of September 30, 2009	$ 1,891,003
Goodwill acquired	136,431
Purchase accounting adjustments	33,891
Effect of foreign currency translation	(19,735)
Balance as of June 30, 2010	$ 2,041,590

Purchase accounting adjustments recorded during the nine months ended June 30, 2010 consisted primarily of a $13.1 million increase due to change in the fair value estimate of acquired intangible assets from our fourth quarter fiscal 2009 acquisition, a $11.3 million increase related to Phonetic earn-out payment, an $8.3 million increase to the SNAPin earn-out liability based on final earn-out value discussed in Note 5 above and a $3.7 million release of escrow cash after the satisfaction of certain pre-acquisition tax related claims. These increases were partially offset by a $1.9 million reduction to the Philips Speech Recognition Systems GMBH (PSRS) purchase price based on a final working capital adjustment agreed between us and the former shareholder of PSRS in November 2009.

Intangible assets consist of the following as of June 30, 2010 (table in thousands, except for years):

	June 30, 2010			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Remaining Life (Years)
Customer relationships	$ 573,059	$ (212,361)	$ 360,698	6.8
Technology and patents	369,034	(118,323)	250,711	6.3
Tradenames, trademarks, and other	38,641	(11,629)	27,012	4.5
Non-competition agreements	4,567	(2,909)	1,658	1.7
Subtotal	985,301	(345,222)	640,079	6.5
Tradename, indefinite life	27,800		27,800	n/a
Total	$ 1,013,101	$ (345,222)	$ 667,879	

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In June 2009, we entered into a joint marketing and selling agreement with a third party and paid $7.0 million in consideration of the arrangement. We have capitalized the $7.0 million payment as an intangible asset, included in the tradenames, trademarks, and other grouping above, and assigned a useful life of 3 years, commensurate with the legal term of the rights in the arrangement. In addition to the $7.0 million paid in June 2009, we also issued 879,567 shares of our common stock, valued at $13.0 million, in December 2009 as an additional payment, upon the third party meeting certain performance criteria under the agreement by October 31, 2009. The additional $13.0 million was capitalized and classified in the same manner as the initial $7.0 million payment.

In March 2010, we acquired a portfolio of technology patents as well as a royalty-free, paid-up perpetual source and object code license from third-parties for $12.5 million, including $2.5 million in cash and 607,903 shares of our common stock valued at $10.0 million. The estimated useful lives of the patent portfolio and the software license are 13 years and 7 years, respectively. Both the patent portfolio and the license have been included within the technology and patents grouping above.

In June 2010, we acquired a perpetual source and object code license from a third-party for $7.5 million. The estimated useful life of the license is approximately 13 years. The license has been included within the technology and patents grouping above.

Estimated amortization expense for each of the five succeeding years and thereafter, is as follows (in thousands):

Year Ending September 30,	Cost of Revenue	Operating Expenses	Total
2010 (July 1, 2010 to September 30, 2010)	$ 12,372	$ 21,423	$ 33,795
2011	48,459	79,679	128,138
2012	44,213	69,406	113,619
2013	38,355	54,986	93,341
2014	29,854	48,229	78,083
Thereafter	77,458	115,645	193,103
Total	$ 250,711	$ 389,368	$ 640,079

7. Financial Instruments and Hedging Activities

Interest Rate Swap Agreements

To manage the interest rate exposure on our variable-rate borrowings, we use interest rate swaps to convert specific variable-rate debt into fixed-rate debt. As of June 30, 2010, we have two outstanding interest rate swaps designated as cash flow hedges with an aggregate notional amount of $200 million. The interest rates on these swaps are 2.7% and 2.1%, plus the applicable margin for the Credit Facility, and they expire in October 2010 and November 2010, respectively. As of June 30, 2010 and September 30, 2009, the aggregate cumulative unrealized losses related to these swaps, were $1.5 million and $4.0 million, respectively and were included in accumulated other comprehensive income (loss) in the accompanying balance sheets.

Forward Currency Contracts Designated as Cash Flow Hedges

On October 1, 2009, we entered into foreign currency contracts to hedge exposure on the variability of cash flows in Canadian dollars with a total notional amount of CAD$8.7 million. These contracts are designated as cash flow hedges. At June 30, 2010, one contract with an unsettled notional amount of CAD$0.3 million ($0.3 million based on the June 30, 2010 exchange rate) remained outstanding and was settled on July 13, 2010. As of June 30, 2010, the aggregate cumulative unrealized gains related to these contracts were immaterial.

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In February and April 2010, we entered into foreign currency contracts to hedge exposure on the variability of cash flows in Hungarian Forints (HUF) with a total notional amount of HUF 997.0 million. These contracts are designated as cash flow hedges. At June 30, 2010, these contracts had an aggregate remaining, unsettled notional amount of HUF 403.0 million ($1.7 million based on the June 30, 2010 exchange rate). These contracts settle monthly through December 2010. As of June 30, 2010, the aggregate cumulative unrealized gains related to these contracts were immaterial.

Other Derivative Activities

During the three months ended December 31, 2008, we entered into foreign currency forward contracts to offset foreign currency exposure on the deferred acquisition payment of 44.3 million related to our acquisition of PSRS, resulting in a net gain during that period of $8.0 million included in other income (expense). The foreign currency contracts matured and were settled on October 22, 2009. The gain for the period from September 30, 2009 to settlement on October 22, 2009 was $1.6 million, but was offset in other income (expense), net by the loss resulting from the corresponding change in the associated deferred acquisition payment liability.

In June 2009, we acquired certain intangible assets and issued 1,809,353 shares of our common stock, valued at $25.0 million, as part of the total consideration. We also issued an additional 315,790 shares of our common stock, valued at $4.5 million, in June 2009 as a prepayment for professional services. The shares issued are subject to security price guarantees which are accounted for as derivatives, and are being accounted for separately from their host agreements due to the determination that such instruments would not be considered equity instruments if freestanding. The security price guarantees require a payment from either us to the third party, or from the third party to us based upon the difference between the price of our common stock on the issue date and an average price of our common stock approximately six months following the issue date. Changes in fair value of these security price guarantees are reported in earnings each period as non-operating income (expense) within other income (expense), net. These security price guarantees expired and were settled in December 2009 and January 2010. The third-party paid $3.8 million to the Company during January 2010 as final settlement.

In October and December 2009, we issued 1,047,120 and 879,567 shares of our common stock in payment to a third party, valued at $16.0 million and $13.0 million, respectively. The $16.0 million payment was our first payment in consideration for the research and development services of the third party in connection with the five-year collaboration arrangement discussed in Note 2 above, while the $13.0 million payment was final payment in respect of the joint marketing and selling agreement with the same third party discussed in Note 6 above. These shares are subject to security price guarantees of the same nature as those described above. The third-party paid $2.6 million and $0.9 million in April 2010 and July 2010, respectively, to the Company as final settlement of these two security price guarantees.

In March 2010, we issued 607,903 and 145,897 shares of our common stock in payment to a third party, valued at $10.0 million and $2.4 million, respectively. The $10.0 million payment was for the purchase of the source and object code software license discussed in Note 6 above, while the $2.4 million payment was in respect of the amendment of the five-year collaboration agreement discussed in Note 2 above. These shares are subject to security price guarantees of the same nature as those described above.

In June 2010, we issued 152,440 shares of our common stock in payment to a third party. These shares are subject to security price guarantees of the same nature as those described above.

As of June 30, 2010, we have outstanding security price guarantees relative to a total of 1,785,807 shares of our common stock issued to a third party. For the three and nine months ended June 30, 2010, we recorded a decrease in fair value of $1.0 million and an increase in fair value of $3.7 million, respectively, related to the settled and unsettled security price guarantees within other income (expense), net in the consolidated statements of operations.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table provides a quantitative summary of the fair value of our hedged and non-hedged derivative instruments as of June 30, 2010 and September 30, 2009 (table in thousands):

		Fair Value	
Description	Balance Sheet Classification	June 30, 2010	September 30, 2009
Derivatives Not Designated as Hedges:			
Foreign currency contracts	Prepaid expenses and other current assets	$	$ 8,682
Security price guarantees	Prepaid expenses and other current assets	915	2,299
Security price guarantees	Accrued expenses and other current liabilities	(1,343)	
Net asset (liability) value of non-hedged derivative instruments		$ (428)	$ 10,981
Derivatives Designated as Hedges:			
Foreign currency contracts	Prepaid expenses and other current assets	$ 9	$
Foreign currency contracts	Accrued expenses and other current liabilities	(298)	
Interest rate swaps	Accrued expenses and other current liabilities(a)	(1,465)	(3,982)
Net asset (liability) value of hedged derivative instruments		$ (1,754)	$ (3,982)

(a) The fair value of the interest rate swaps was classified in other long-term liabilities as of September 30, 2009 as the settlement date for the swaps was greater than twelve months from the balance sheet date.

The following tables summarize the activity of derivative instruments for fiscal 2010 and 2009 (tables in thousands):

Derivatives Designated as Hedges for the Three Months Ended June 30,

Amount of Gain (Loss) Recognized in OCI		Location and Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	
2010	2009	2010	2009

Foreign currency contracts	$ (321)	$ 544	Other income (expense), net	$ (98)	$ 190
Interest rate swaps	$ 1,109	$ 700	N/A	$	$

Derivatives Designated as Hedges for the Nine Months Ended June 30,

	Amount of Gain (Loss) Recognized in OCI		Location and Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		
	2010	**2009**		**2010**	**2009**
Foreign currency contracts	$ (99)	$ 158	Other income (expense), net	$ (190)	$ 190
Interest rate swaps	$ 2,517	$ (3,143)	N/A	$	$

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Derivatives Not Designated as Hedges

	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income Three Months Ended June 30, 2010	2009	Nine Months Ended June 30, 2010	2009
Foreign currency contracts	Other income (expense), net	$	$3,721	$	$ 6,272
Security price guarantees	Other income (expense), net	$ (1,044)	$(3,782)	$ 3,664	$ (3,782)

Other Financial Instruments

Financial instruments, including cash equivalents, restricted cash, accounts receivable, and derivative instruments, are carried in the consolidated financial statements at amounts that approximate their fair value. Refer to Note 12 for discussion of fair value of our long-term debt.

8. Fair Value Measures

Fair value is defined as the price that would be received for an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. Valuation techniques must maximize the use of observable inputs and minimize the use of unobservable inputs. When determining the fair value measurements for assets and liabilities required to be recorded at fair value, we consider the principal or most advantageous market in which we would transact and consider assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of nonperformance.

ASC 820 (formerly referred to as SFAS No. 157, *Fair Value* Measurements) establishes a value hierarchy based on three levels of inputs, of which the first two are considered observable and the third is considered unobservable:

Level 1. Quoted prices for identical assets or liabilities in active markets which we can access.

Level 2. Observable inputs other than those described as Level 1.

Level 3. Unobservable inputs.

Assets and liabilities measured at fair value on a recurring basis at June 30, 2010 consisted of (table in thousands):

	June 30, 2010 Level 1	Level 2	Level 3	Total
Assets:				
Money market funds(a)	$ 424,331	$	$	$ 424,331
US government agency securities(a)	10,000			10,000

Foreign currency exchange contracts(b)		9		9
Total assets at fair value	$ 434,331	$ 9	$	$ 434,340
Liabilities:				
Foreign currency exchange contracts(b)	$	$ 298	$	$ 298
Security price guarantees(c)		428		428
Contingent consideration(d)			803	803
Interest rate swaps(e)		1,465		1,465
Total liabilities at fair value	$	$ 2,191	$ 803	$ 2,994

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(a) Money market funds and US government agency securities, included in cash and cash equivalents in the accompanying balance sheet, are valued at quoted market prices in active markets.

(b) The fair value of our foreign currency exchange contracts is the intrinsic value of the contracts based on observable inputs for similar derivative instruments in active markets or quoted prices for identical or similar instruments in markets that are not active or are directly or indirectly observable.

(c) The fair values of the security price guarantees are determined using a modified Black-Scholes model, derived from observable inputs such as US treasury interest rates, our common stock price, and the volatility of our common stock. The valuation model values both the put and call components of the guarantees simultaneously, with the net value of those components representing the fair value of each instrument.

(d) The fair value of our contingent consideration arrangement is determined based on the Company s evaluation as to the probability and amount of any earn-out that will be achieved based on expected future performance by the acquired entity, as well as our common stock price since the contingent consideration arrangement is payable in shares of our common stock. Refer to Note 5 for additional information.

(e) The fair values of the interest rate swaps are estimated using discounted cash flow analyses that factor in observable market inputs such as LIBOR based yield curves, forward rates, and credit spreads.

Level 3 Instruments

As of June 30, 2010, only our contingent consideration arrangement, entered into during the second quarter of fiscal 2010, qualifies as a Level 3 instrument. Prior to the second quarter fiscal 2010, we have not had any Level 3 instruments. $1.0 million of the fair value of the instrument was recorded as part of the consideration transferred for one of our second quarter fiscal 2010 acquisitions. The remaining $0.2 million change in fair value between the acquisition date and June 30, 2010 is recorded as income in acquisition-related costs, net in our consolidated statements of operations.

9. Accrued Expenses and Other Current Liabilities

Accrued expenses consisted of the following (in thousands):

	June 30, 2010	September 30, 2009
Compensation	$ 56,122	$ 52,600
Sales and marketing incentives(a)	35,600	4,413
Cost of revenue related liabilities	12,434	7,585
Professional fees	7,131	8,945
Income taxes payable	5,735	7,185
Sales and other taxes payable	5,619	5,913
Acquisition costs and liabilities	5,038	8,522

Deferred tax liability	1,578	1,614
Security price guarantees	1,343	
Other	7,938	8,042
Total	$ 138,538	$ 104,819

(a) Accrued sales and marketing incentives include a EUR 25.0 million ($30.5 million based on the June 30, 2010 exchange rate) fixed obligation assumed in connection with our acquisition of SpinVox as disclosed in Note 4. During the third quarter of fiscal 2010, we placed EUR 18.0 million ($22.0 million based on the June 30, 2010 exchange rate) in an irrevocable standby letter of credit account. The fund is restricted for the payment of the

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fixed obligation, payable in cash, in December 2010 and has been reported as restricted cash in the accompanying balance sheets.

10. Accrued Business Combination Costs

The activity for the nine months ended June 30, 2010, relating to all facilities and personnel recorded in accrued business combination costs, is as follows (in thousands):

	Facilities	Personnel	Total
Balance at September 30, 2009	$ 34,551	$ 2,497	$ 37,048
Charged to goodwill	(15)	(759)	(774)
Charged to restructuring and other charges, net	(527)		(527)
Charged to interest expense	965		965
Cash payments, net of sublease receipts	(8,465)	(1,592)	(10,057)
Balance at June 30, 2010	$ 26,509	$ 146	$ 26,655

	June 30, 2010	September 30, 2009
Reported as:		
Current	$ 9,574	$ 12,144
Long-term	17,081	24,904
Total	$ 26,655	$ 37,048

11. Restructuring and Other Charges, net

The following table sets forth the nine months ended June 30, 2010 accrual activity relating to restructuring and other charges (in thousands):

	Personnel	Facilities	Other	Total
Balance at September 30, 2009	$ 607	$ 310	$ 28	$ 945
Restructuring and other charges, net	8,195	155	8,421	16,771
Non-cash adjustments			(6,833)	(6,833)
Cash payments	(6,672)	(126)	(1,616)	(8,414)
Balance at June 30, 2010	$ 2,130	$ 339	$	$ 2,469

For the nine months ended June 30, 2010, we recorded net restructuring and other charges of $16.8 million, which consisted primarily of $8.2 million related to the elimination of approximately 160 personnel across multiple functions within our company, including acquired entities, a $6.9 million write-off of previously capitalized patent defense costs as a result of unsuccessful litigation and $1.6 million of contract termination costs.

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12. Credit Facilities and Debt

At June 30, 2010 and September 30, 2009, we had the following borrowing obligations (in thousands):

	June 30, 2010	September 30, 2009
2.75% Convertible Debentures, net of unamortized discount of $38.5 million and $44.9 million, respectively	$ 211,477	$ 205,064
Credit Facility	645,238	650,263
Obligations under capital leases	1,846	307
Other	48	126
Total long-term debt	858,609	855,760
Less: current portion	8,209	6,862
Non-current portion of long-term debt	$ 850,400	$ 848,898

The estimated fair value of our long-term debt approximated $872.1 million at June 30, 2010 and $893.2 million at September 30, 2009. These fair value amounts represent the value at which our lenders could trade our debt within the financial markets, and do not represent the settlement value of these long-term debt liabilities to us at each reporting date. The fair value of these long-term debt issues will continue to fluctuate each period based on fluctuations in market interest rates, and these fluctuations may have little to no correlation to our outstanding debt balances. The decrease in fair value from September 30, 2009 to June 30, 2010 is generally attributable to the overall decline in the debt markets. The term loan portion of our Credit Facility is traded and the fair values are based upon traded prices as of the reporting dates. The fair values of the 2.75% Convertible Debentures were estimated using the averages of the bid and ask trading quotes as of each respective reporting date. We had no outstanding balance on the revolving credit line portion of our Credit Facility. Our capital lease obligations and other debt are not traded and the fair values of these instruments are assumed to approximate their carrying values as of June 30, 2010 and September 30, 2009.

2.75% Convertible Debentures

On August 13, 2007, we issued $250 million of 2.75% convertible senior debentures due in August 2027. As of June 30, 2010, no conversion triggers were met. If the conversion triggers were met, we could be required to repay all or some of the principal amount in cash prior to maturity.

Adoption of ASC 470-20

As discussed in Note 2 above, on October 1, 2009, we adopted ASC 470-20, which has been applied retrospectively to all periods presented in our consolidated financial statements. ASC 470-20 is applicable to our 2.75% Convertible Debentures as we have the right to deliver cash in lieu of shares of our common stock, or a combination of cash and shares of common stock, upon conversion for each of these issuances.

We recognized total interest expense of approximately $10.0 and $30.4 million during the three and nine months ended June 30, 2010, respectively, and $10.1 and $36.8 million during the three and nine months ended June 30, 2009 related to the contractual interest coupon on all our outstanding long-term debt, amortization of debt issuance costs, and amortization of the discount on the liability component of our 2.75% Convertible Debentures. The effective interest rate on the liability component of our 2.75% Convertible Debentures, including both the cash and non-cash interest components, was approximately 7% during the three and nine months ended June 30, 2010 and 2009. We are amortizing the discount on the liability component of our 2.75% Convertible Debentures through August 2014, which is the first put date available to the holders of the notes.

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The carrying amount of the equity component, principal amount of the liability component, unamortized debt discount related to the liability component and net carrying amount of the liability component of our debt subject to ASC 470-20 as of June 30, 2010 and September 30, 2009 were as follows (in thousands):

	June 30, 2010	September 30, 2009
Carrying amount of equity component (conversion options)	$ 54,695	$ 54,695
Principal amount of liability component	$ 250,000	$ 250,000
Unamortized discount related to liability component	(38,523)	(44,936)
Net carrying amount of liability component	$ 211,477	$ 205,064

Credit Facility

We have a credit facility which consists of a $75 million revolving credit line, reduced by outstanding letters of credit, a $355 million term loan entered into on March 31, 2006, a $90 million term loan entered into on April 5, 2007 and a $225 million term loan entered into on August 24, 2007 (collectively the Credit Facility). The term loans are due March 2013 and the revolving credit line is due March 2012. As of June 30, 2010, there were $15.9 million of letters of credit issued under the revolving credit line and there were no other outstanding borrowings under the revolving credit line. As of June 30, 2010, we are in compliance with the covenants under the Credit Facility.

As of June 30, 2010, based on our leverage ratio, the applicable margin for our term loan was 1.00% for base rate borrowings and 2.00% for LIBOR-based borrowings. This results in an effective interest rate of 2.36%. No payments under the excess cash flow sweep provision were due in the first quarter of fiscal 2010 as no excess cash flow, as defined, was generated in fiscal 2009. At the current time, we are unable to predict the amount of the outstanding principal, if any, that we may be required to repay in future fiscal years pursuant to the excess cash flow sweep provisions. If only the minimum required repayments are made, the annual aggregate principal amount of the term loans repaid would be as follows (table in thousands):

Year Ending September 30,	Amount
2010 (July 1, 2010 to September 30, 2010)	$ 1,675
2011	6,700
2012	6,700
2013 (maturity)	630,163
Total	$ 645,238

13. Net Income (Loss) Per Share

Common equivalent shares are excluded from the computation of diluted net income (loss) per share if their effect is anti-dilutive. Potentially dilutive common equivalent shares aggregating to 19.9 million and 21.8 million shares for the three and nine months ended June 30, 2010, respectively, and 30.5 million and 32.5 million shares for the three and nine months ended June 30, 2009, respectively, have been excluded from the computation of diluted net loss per share because their inclusion would be anti-dilutive.

14. Stockholders Equity

On March 19, 2004, we announced that Warburg Pincus had agreed to purchase all outstanding shares of and warrants for our common stock held by Xerox Corporation for approximately $80.0 million. In connection with this transaction, Warburg Pincus acquired new warrants to purchase 2.5 million additional shares of our common stock for total consideration of $0.6 million. The warrants had a six-year life and an exercise price of $4.94 per share. In

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April 2010, the warrants to purchase 2.5 million shares of our common stock were exercised in full, with total cash proceeds to the Company of $12.4 million.

15. Stock-Based Compensation

We recognize stock-based compensation expense over the requisite service period. Our share-based awards are accounted for as equity instruments. The amounts included in the consolidated statements of operations relating to stock-based compensation are as follows (dollars in thousands):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Cost of product and licensing	$ 7	$ 2	$ 25	$ 8
Cost of professional services and hosting	2,612	2,402	8,173	7,329
Cost of maintenance and support	165	132	582	557
Research and development	2,282	2,013	6,731	7,640
Sales and marketing	12,516	6,687	29,813	20,246
General and administrative	10,512	6,346	27,544	16,804
Total	$ 28,094	$ 17,582	$ 72,868	$ 52,584

Stock Options

The table below summarizes activity relating to stock options for the nine months ended June 30, 2010:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value(1)
Outstanding at September 30, 2009	13,553,866	$ 7.48		
Granted	1,200,000	$ 13.81		
Exercised	(3,235,920)	$ 5.36		
Forfeited	(331,559)	$ 13.62		
Expired	(99,788)	$ 15.87		
Outstanding at June 30, 2010	11,086,599	$ 8.52	3.7 years	$ 73.5 million
Exercisable at June 30, 2010	8,021,090	$ 6.94	2.9 years	$ 65.9 million

Exercisable at June 30, 2009	10,618,417	$	6.01	3.5 years	$	68.6 million

(1) The aggregate intrinsic value in this table was calculated based on the positive difference, if any, between the closing market value of our common stock on June 30, 2010 ($14.95) and the exercise price of the underlying options.

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of June 30, 2010, the total unamortized fair value of stock options was $14.6 million with a weighted average remaining recognition period of 0.9 years. A summary of weighted-average grant-date fair value of stock options granted and intrinsic value of stock options exercised is as follows:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Weighted-average grant-date fair value per share	n/a	$ 6.23	$ 5.90	$ 8.15
Total intrinsic value of stock options exercised (in millions)	$ 7.1	$ 6.6	$ 34.1	$ 15.0

We use the Black-Scholes option pricing model to calculate the grant-date fair value of an award. The fair value of the stock options granted and unvested options assumed from acquisitions during the three and nine months ended June 30, 2010 and 2009 were calculated using the following weighted-average assumptions:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Dividend yield	n/a	0.0%	0.0%	0.0%
Expected volatility	n/a	53.9%	50.9%	55.3%
Average risk-free interest rate	n/a	2.5%	2.4%	2.7%
Expected term (in years)	n/a	5.7	4.2	5.9

Restricted Units

Restricted Units are not included in issued and outstanding common stock until the shares are vested and released. The table below summarizes activity relating to Restricted Units for the nine months ending June 30, 2010:

	Number of Shares Underlying Restricted Units Contingent Awards	Number of Shares Underlying Restricted Units Time-Based Awards
Outstanding at September 30, 2009	2,840,673	8,755,330
Granted	1,519,243	2,832,453
Earned/released	(918,015)	(3,177,899)
Forfeited	(650,756)	(701,667)
Outstanding at June 30, 2010	2,791,145	7,708,217

Weighted average remaining contractual term of outstanding Restricted Units		1.0 years		1.1 years
Aggregate intrinsic value of outstanding Restricted Units(1)	$	41.7 million	$	115.2 million
Restricted Units vested and expected to vest		2,467,305		6,678,209
Weighted average remaining contractual term of Restricted Units vested and expected to vest		0.9 years		1.1 years
Aggregate intrinsic value of Restricted Units vested and expected to vest(1)	$	36.9 million	$	99.8 million

(1) The aggregate intrinsic value in this table was calculated based on the positive difference between the closing market value of our common stock on June 30, 2010 ($14.95) and the exercise price of the underlying Restricted Units.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The purchase price for vested Restricted Units is $0.001 per share. As of June 30, 2010, unearned stock-based compensation expense related to all unvested Restricted Units is $119.0 million, which will, based on expectations of future performance vesting criteria, where applicable, be recognized over a weighted-average period of 1.5 years.

A summary of weighted-average grant-date fair value, including those assumed in respective periods, and intrinsic value of all Restricted Units vested is as follows:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Weighted-average grant-date fair value per share	$ 17.39	$ 12.30	$ 15.59	$ 10.54
Total intrinsic value of shares vested (in millions)	$ 29.0	$ 5.5	$ 65.2	$ 29.3

16. Income Taxes

The effective tax rate was 608.3% and 173.0% for the three months ended June 30, 2010 and 2009, respectively, and (26.6)% and (263.1)% for the nine months ended June 30, 2010 and 2009, respectively. Included in the tax provision for the three months ended June 30, 2010 was $2.7 million in foreign income tax provision, reduced by a $1.1 million discrete tax benefit resulting from the release of a contingency upon a favorable federal audit settlement.

Included in the tax provision for the nine months ended June 30, 2010 was $8.1 million in foreign income tax provision, reduced by the release of a $1.1 million U.S. federal tax audit contingency discussed above. Also included was a $1.1 million tax benefit resulting from certain international research and development tax credits, and a $1.0 million tax benefit resulting from the favorable settlement of a state tax penalty related to our acquisition of eScription. No tax benefit has been recognized for the U.S. losses in either the three or nine month periods ended June 30, 2010 and 2009, as the realization of such tax benefit is not more likely than not.

At June 30, 2010 and September 30, 2009, the liability for income taxes associated with uncertain tax positions was $11.5 million and $12.1 million, respectively. The decrease is primarily attributable to the favorable settlement of certain US tax contingencies. We do not expect a significant change in the amount of unrecognized tax benefits within the next 12 months.

17. Commitments and Contingencies

Operating Leases

The following table outlines our gross future minimum payments under all non-cancelable operating leases as of June 30, 2010 (in thousands):

	Other Contractual

Year Ending September 30,	Operating Leases	Leases Under Restructuring	Obligations Assumed	Total
2010 (July 1, 2010 to September 30, 2010)	$ 5,802	$ 1,019	$ 3,422	$ 10,243
2011	20,908	3,287	13,947	38,142
2012	18,745	1,997	12,299	33,041
2013	16,943	901	2,321	20,165
2014	14,176		2,326	16,502
Thereafter	45,377		3,296	48,673
Total	$ 121,951	$ 7,204	$ 37,611	$ 166,766

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

At June 30, 2010, we have subleased certain office space that is included in the above table to third parties. Total sublease income under contractual terms is $14.5 million and ranges from approximately $1.5 million to $4.1 million on an annual basis through February 2016.

Litigation and Other Claims

Like many companies in the software industry, we have, from time to time, been notified of claims that we may be infringing, or contributing to the infringement of, the intellectual property rights of others. These claims have been referred to counsel, and they are in various stages of evaluation and negotiation. If it appears necessary or desirable, we may seek licenses for these intellectual property rights. There is no assurance that licenses will be offered by all claimants, that the terms of any offered licenses will be acceptable to us or that in all cases the dispute will be resolved without litigation, which may be time consuming and expensive, and may result in injunctive relief or the payment of damages by us.

Vianix LLC has filed three legal actions against us, consisting of two breach of contract actions and a copyright infringement claim. We believe that our maximum potential exposure, specifically related to one of the breach of contract actions and the copyright infringement claim, is immaterial. It is too early for us to reach a conclusion as to the ultimate outcome or proposed settlement of these actions, or to estimate the potential loss that could result from a settlement or adverse judgment against us in the second breach of contact action. We have not accrued any liability for these actions as we believe that we have substantial defenses against these claims, and intend to defend them vigorously.

We do not believe that the final outcome of the above litigation matters will have a material adverse effect on our financial position and results of operations. However, even if our defense is successful, the litigation could require significant management time and will be costly. Should we not prevail, our operating results, financial position and cash flows could be adversely impacted.

Guarantees and Other

We include indemnification provisions in the contracts we enter into with customers and business partners. Generally, these provisions require us to defend claims arising out of our products infringement of third-party intellectual property rights, breach of contractual obligations and/or unlawful or otherwise culpable conduct. The indemnity obligations generally cover damages, costs and attorneys fees arising out of such claims. In most, but not all, cases, our total liability under such provisions is limited to either the value of the contract or a specified, agreed upon amount. In some cases our total liability under such provisions is unlimited. In many, but not all, cases, the term of the indemnity provision is perpetual. While the maximum potential amount of future payments we could be required to make under all the indemnification provisions is unlimited, we believe the estimated fair value of these provisions is minimal due to the low frequency with which these provisions have been triggered.

We indemnify our directors and officers to the fullest extent permitted by law. These agreements, among other things, indemnify directors and officers for expenses, judgments, fines, penalties and settlement amounts incurred by such persons in their capacity as a director or officer of the company, regardless of whether the individual is serving in any such capacity at the time the liability or expense is incurred. Additionally, in connection with certain acquisitions we have agreed to indemnify the former officers and members of the boards of directors of those companies, on similar terms as described above, for a period of six years from the acquisition date. In certain cases we purchase director and

officer insurance policies related to these obligations, which fully cover the six year periods. To the extent that we do not purchase a director and officer insurance policy for the full period of any contractual indemnification, we would be required to pay for costs incurred, if any, as described above.

18. Segment and Geographic Information and Significant Customers

We follow the provisions of ASC 280 (formerly referred to as SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*), which establishes standards for reporting information about operating

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

segments. ASC 280 also established standards for disclosures about products, services and geographic areas. Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Our chief operating decision maker (CODM) is the Chief Executive Officer of the Company.

We have several customer-facing market groups that oversee the core markets where we conduct business. These groups are referred to as Mobile-Enterprise, Healthcare-Dictation, and Imaging. These groups do not directly manage centralized or shared resources or the allocation decisions regarding the activities related to these functions, which include sales and sales operations, certain research and development initiatives, business development and all general and administrative activities. Our CODM oversees these groups as well as each of the functions that provide the shared and centralized activities noted above. To manage the business, allocate resources and assess performance, the CODM primarily reviews revenue data by market group, while reviewing gross margins, operating margins, and other measures of income or loss on a consolidated basis. Thus, we have determined that we operate in one segment.

The following table presents revenue information for our three core markets (in thousands):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	**2009**	**2010**	**2009**
Mobile-Enterprise	$ 125,734	$ 118,056	$ 386,815	$ 332,384
Healthcare-Dictation	125,087	105,575	363,524	306,121
Imaging	22,382	17,409	58,846	48,514
Total	$ 273,203	$ 241,040	$ 809,185	$ 687,019

No country outside of the United States provided greater than 10% of our total revenue. Revenue, classified by the major geographic areas in which our customers are located, was as follows (table in thousands):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	**2009**	**2010**	**2009**
United States	$ 202,080	$ 185,111	$ 576,122	$ 519,576
International	71,123	55,929	233,063	167,443
Total	$ 273,203	$ 241,040	$ 809,185	$ 687,019

No country outside of the United States held greater than 10% of our long-lived or total assets. Our long-lived assets, including intangible assets and goodwill, were located as follows (table in thousands):

	June 30, 2010	September 30, 2009
United States	$ 2,415,726	$ 2,395,773
International	417,743	307,864
Total	$ 2,833,469	$ 2,703,637

19. Related Parties

A member of our Board of Directors is also a partner at Wilson Sonsini Goodrich & Rosati, Professional Corporation, a law firm that provides professional services to us. These services may from time-to-time include contingent fee arrangements. We paid Wilson Sonsini Goodrich & Rosati $0.3 million and $2.3 million for the three and nine months ended June 30, 2010 for professional services. As of June 30, 2010 and September 30, 2009, we had $2.0 million and $1.7 million, respectively, included in accounts payable and accrued expenses to Wilson Sonsini Goodrich & Rosati.

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

The following Management s Discussion and Analysis is intended to help the reader understand the results of operations and financial condition of our business. Management s Discussion and Analysis is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and the accompanying notes to the consolidated financial statements.

FORWARD-LOOKING STATEMENTS

This Quarterly Report contains forward-looking statements, including predictions regarding:

- our future revenue, cost of revenue, research and development expenses, selling, general and administrative expenses, amortization of intangible assets and gross margin;
- our strategy relating to our core markets;
- the potential of future product releases;
- our product development plans and investments in research and development;
- future acquisitions, and anticipated benefits from pending and prior acquisitions;
- international operations and localized versions of our products; and
- legal proceedings and litigation matters.

You can identify these and other forward-looking statements by the use of words such as may, will, should, expects, plans, anticipates, believes, estimates, predicts, intends, potential, continue or the negative of such term comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks described in Item 1A Risk Factors of Part II and elsewhere in this Quarterly Report.

You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

OVERVIEW

Nuance Communications, Inc. is a leading provider of speech, imaging and keypad solutions for businesses, organizations and consumers around the world. Our technologies, applications and services make the user experience more compelling by transforming the way people interact with devices and systems, and how they create, share and use documents. Our solutions are used every day by millions of people and thousands of businesses for tasks and services such as requesting information from a phone-based self-service solution, dictating medical records, searching the mobile Web by voice, entering a destination into a navigation system, or working with PDF documents. Our solutions help make these interactions, tasks and experiences more productive, compelling and efficient.

Our technologies address our three core markets:

Mobile-Enterprise. We deliver a portfolio of solutions that improve the experience of customer communications, mobile interactions and personal productivity. Combining our expertise in enterprise and mobile solutions allows us to help consumers, businesses and manufacturers more effectively utilize mobile devices for accessing an array of content, services and capabilities. Our enterprise solutions help automate a wide range of customer services and business processes in a variety of information and process-intensive vertical markets such as telecommunications, financial services, utilities, travel and entertainment, and government. Our mobile solutions add voice control and texting capabilities to mobile devices and services, allowing people to more easily dial a mobile phone, enter destination information into an automotive navigation system, dictate a text message or have emails and screen information read aloud.

Healthcare-Dictation. Our healthcare solutions comprise a portfolio of speech-driven clinical documentation and communication solutions that help healthcare provider organizations reduce operating costs, increase reimbursement, and enhance patient care and safety. Our solutions automate the input and management of medical information and are used by many of the largest hospitals in the United States. We offer a variety of different solutions and deployment options to address the specific requirements of different healthcare provider organizations. Our Dragon NaturallySpeaking family of products help people and businesses increase productivity by using speech to create documents, streamline repetitive and complex tasks, input data, complete forms and automate manual transcription processes. Our Dragon Medical solution is a desktop application that provides front-end speech recognition that allows smaller groups of physicians and clinicians to create and navigate medical records.

Imaging. Our PDF and document imaging solutions reduce the time and cost associated with creating, using and sharing documents. Our solutions benefit from the widespread adoption of the PDF format and the increasing demand for networked solutions for managing electronic documents. Our solutions are used by millions of professionals and within large enterprises.

We leverage our global professional services organization and our network of partners to design and deploy innovative solutions for businesses and organizations around the globe. We market and distribute our products through a global network of resellers, including system integrators, independent software vendors, value-added resellers, hardware vendors, telecommunications carriers and distributors, and also sell directly through a dedicated sales force and through our e-commerce website.

Confronted by dramatic increases in electronic information, consumers, business personnel and healthcare professionals must use a variety of resources to retrieve information, transcribe patient records, conduct transactions and perform other job-related functions. We believe that the power of our solutions can transform the way people use the Internet, telecommunications systems, electronic medical records, wireless and mobile networks and related corporate infrastructure to conduct business.

We have built a world-class portfolio of intellectual property, technologies, applications and solutions through both internal development and acquisitions. We expect to continue to pursue opportunities to broaden these assets and expand our customer base through acquisitions. In evaluating the financial condition and operating performance of our business, management focuses on revenue, earnings, gross margins, operating margins and cash flow from operations. A summary of these key financial metrics for the three-month period ended June 30, 2010, as compared to the three-month period ended June 30, 2009, is as follows:

Total revenue increased by $32.2 million to $273.2 million;

Net loss decreased by $1.3 million to $1.5 million;

Gross profit increased by 1.7 percentage points to 62.7%;

Operating margins decreased to 1.7% from 7.1%; and

Cash provided by operating activities for the nine months ended June 30, 2010 was $184.7 million, an increase of $0.4 million from the same period in the prior fiscal year.

CRITICAL ACCOUNTING POLICIES

Generally accepted accounting principles in the United States (GAAP) require us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. On an ongoing basis, we evaluate our estimates, assumptions and judgments, including those related to: revenue recognition; allowance for doubtful accounts and returns; the costs to complete the development of custom software applications; the valuation of goodwill, intangible assets and tangible long-lived assets; accounting for business combinations; share-based payments; valuation of derivative instruments; accounting for income taxes and related valuation allowances and loss contingencies. Our management bases its estimates on

historical experience, market participant fair value considerations and various other factors that are believed to be reasonable under the circumstances. Actual results could differ from these estimates.

Information about those accounting policies we deem to be critical to our financial reporting may be found in our Annual Report on Form 10-K for the fiscal year ended September 30, 2009. There have been no significant changes or additions to our critical accounting policies from those disclosed in our annual report other than those changes in our policies for accounting for business combinations resulting from our adoption of ASC 805 [formerly referred to as Statement of Financial Accounting Standards (SFAS) No. 141(Revised), *Business Combinations* (SFAS 141R)], as described in Note 2 to the unaudited consolidated financial statements included in Item 1 of Part I of this Quarterly Report on Form 10-Q.

RECENTLY ISSUED ACCOUNTING STANDARDS

Refer to Note 2 to the unaudited consolidated financial statements included in Item 1 of Part I of this Quarterly Report on Form 10-Q.

RESULTS OF OPERATIONS

The following table presents, as a percentage of total revenue, certain selected financial data for the three and nine months ended June 30, 2010 and 2009 (as adjusted for the retrospective application of FASB ASC 470-20).

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Revenue:				
Product and licensing	39.8%	36.3%	41.4%	37.8%
Professional services and hosting	43.2	46.0	41.8	44.3
Maintenance and support	17.0	17.7	16.8	17.9
Total revenue	100.0	100.0	100.0	100.0
Cost of revenue:				
Product and licensing	4.0	3.5	4.2	3.8
Professional services and hosting	26.1	28.3	25.5	27.6
Maintenance and support	2.8	3.0	2.9	3.1
Amortization of intangible assets	4.4	4.2	4.4	4.0
Gross profit	62.7	61.0	63.0	61.5
Operating expenses:				
Research and development	14.2	11.5	14.1	12.5
Sales and marketing	24.6	20.8	24.3	23.4
General and administrative	10.9	10.2	11.0	11.0
Amortization of intangible assets	7.9	8.3	8.1	8.2
Acquisition-related costs, net	2.2	1.9	3.3	2.0
Restructuring and other charges, net	1.2	1.2	2.0	0.8

Total operating expenses	61.0	53.9	62.8	57.9
Income from operations	1.7	7.1	0.2	3.6
Other income (expense), net	(1.6)	(5.5)	(2.3)	(4.6)
Income (loss) before income taxes	0.1	1.6	(2.1)	(1.0)
Provision for income taxes	0.7	2.7	0.5	2.5
Net loss	(0.6)%	(1.1)%	(2.6)%	(3.5)%

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Total Revenue

The following tables show total revenue from our three core market groups and revenue by geographic location, based on the location of our customers, in dollars and percentage change (dollars in millions):

	Three Months Ended June 30,		Dollar	Percent	Nine Months Ended June 30,		Dollar	Percent
	2010	2009	Change	Change	2010	2009	Change	Change
Mobile-Enterprise	$ 125.7	$ 118.0	$ 7.7	6.5%	$ 386.8	$ 332.4	$ 54.4	16.4%
Healthcare-Dictation	125.1	105.6	19.5	18.5	363.5	306.1	57.4	18.8
Imaging	22.4	17.4	5.0	28.7	58.9	48.5	10.4	21.4
Total Revenue	$ 273.2	$ 241.0	$ 32.2	13.4%	$ 809.2	$ 687.0	$ 122.2	17.8%
United States	$ 202.1	$ 185.1	$ 17.0	9.2%	$ 576.1	$ 519.6	$ 56.5	10.9%
International	71.1	55.9	15.2	27.2	233.1	167.4	65.7	39.2
Total Revenue	$ 273.2	$ 241.0	$ 32.2	13.4%	$ 809.2	$ 687.0	$ 122.2	17.8%

The increase in total revenue for the three and nine months ended June 30, 2010, as compared to the same periods ended June 30, 2009, was driven by a combination of organic growth and contributions from our acquisitions. Mobile-Enterprise revenue increased primarily due to growth in sales of our predictive text products and embedded speech products for the automotive market, as well as contributions from our voicemail-to-text solutions. Healthcare-Dictation revenue increased primarily due to organic growth from our Dragon Medical and diagnostics products, iChart and eScription transcription services and SpeechMagic solutions. Imaging revenue increased primarily as a result of contributions from our acquisitions of eCopy, Inc. and X-Solutions Group B.V and growth in our core imaging solutions.

Based on the location of our customers, the geographic split for the three and nine months ended June 30, 2010 was 74% and 71%, respectively, of total revenue in the United States and 26% and 29%, respectively, internationally. This represents a shift in revenues toward international as compared to 77% and 76% of total revenue in the United States and 23% and 24% internationally for the same periods in fiscal 2009. The increase in the proportion of revenue generated internationally during the three and nine months ended June 30, 2010 as compared to the same periods in the prior year was primarily due to contributions from our acquisition of SpinVox, as well as the increase in revenue contributions from our predictive text products and SpeechMagic solutions, which are sold predominantly outside the United States.

Product and Licensing Revenue

Product and licensing revenue primarily consists of sales and licenses of our technology. The following table shows product and licensing revenue, in dollars and as a percentage of total revenue (dollars in millions):

Three Months Ended	Nine Months Ended

	June 30, 2010	June 30, 2009	Dollar Change	Percent Change	June 30, 2010	June 30, 2009	Dollar Change	Percent Change
Product and licensing revenue	$ 108.8	$ 87.4	$ 21.4	24.5%	$ 335.2	$ 260.0	$ 75.2	28.9%
As a percentage of total revenue	39.8%	36.3%			41.4%	37.8%		

The increase in product and licensing revenue for the three months ended June 30, 2010, as compared to the three months ended June 30, 2009, consisted of a $7.0 million increase in Mobile-Enterprise revenue primarily due to growth in sales of our predictive text products, as well as sales of our embedded speech products for the automotive market. Healthcare-Dictation revenue increased $10.7 million, primarily driven by increased sales of our Dragon Medical and diagnostics products and SpeechMagic solutions. Imaging revenue increased $3.7 million primarily due to contributions from our acquisitions of eCopy and X-Solutions. The growth in our product and licensing revenue streams outpaced the relative growth of our other revenue types, resulting in the 3.5 percentage point increase as a percent of total revenue.

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The increase in product and licensing revenue for the nine months ended June 30, 2010, as compared to the nine months ended June 30, 2009, consisted of a $37.7 million increase in Mobile-Enterprise revenue primarily due to growth in sales of our predictive text products, as well as sales of our embedded speech products for the automotive market. Healthcare-Dictation revenue increased $29.5 million primarily as a result of increased sales of our SpeechMagic solutions and Dragon Medical products. Imaging revenue increased $8.0 million primarily due to contributions from our acquisitions of X-Solutions and eCopy. The growth in our product and licensing revenue streams outpaced the relative growth of our other revenue types, resulting in the 3.6 percentage point increase as a percent of total revenue.

Professional Services and Hosting Revenue

Professional services revenue primarily consists of consulting, implementation and training services for speech customers. Hosting revenue primarily relates to delivering hosted transcription and dictation services over a specified term, as well as self-service, on-demand offerings to carriers and enterprises. The following table shows professional services and hosting revenue, in dollars and as a percentage of total revenue (dollars in millions):

	Three Months Ended June 30,		Dollar	Percent	Nine Months Ended June 30,		Dollar	Percent
	2010	2009	Change	Change	2010	2009	Change	Change
Professional services and hosting revenue	$ 117.9	$ 111.0	$ 6.9	6.2%	$ 337.8	$ 304.2	$ 33.6	11.0%
As a percentage of total revenue	43.2%	46.0%			41.8%	44.3%		

The increase in professional services and hosting revenue for the three months ended June 30, 2010, as compared to the three months ended June 30, 2009, was driven by a $8.5 million increase in Healthcare-Dictation revenues resulting largely from growth of our iChart and eScription transcription services. During the three months ended June 30, 2010, the annualized line run-rate in our healthcare on-demand business was approximately 3.242 billion lines per year, up 14% from 2.833 billion lines per year during the three months ended June 30, 2009. The annualized line run-rate is determined by the number of lines actually billed in a given quarter, multiplied by four. Mobile-Enterprise revenue decreased $1.7 million primarily due to the timing of revenue recognition related to enterprise set-up and implementation professional services, partially offset by contributions from our voicemail-to-text solutions. Our backlog hours in enterprise professional services were approximately 312,000 hours as of June 30, 2010, compared with approximately 215,000 hours as of June 30, 2009. Enterprise professional services backlog hours reflect the accumulated estimated hours necessary to fulfill all of our existing, executed professional services contracts within the enterprise business, including those that are cancelable by customers, based on the original estimate of hours sold. As a percentage of total revenue, professional services and hosting revenue decreased 2.8 percentage points as compared to the corresponding period in the prior year, primarily due to the strong growth in product and licensing revenue relative to professional services and hosting revenue.

The increase in professional services and hosting revenue for the nine months ended June 30, 2010, as compared to the nine months ended June 30, 2009, was driven by a $24.3 million increase in Healthcare-Dictation revenues resulting largely from growth of our iChart and eScription transcription services. During the nine months ended

June 30, 2010, the number of healthcare transcription lines processed increased as compared to the corresponding period in the prior year. Mobile-Enterprise revenue increased $8.9 million, primarily due to contributions from our voicemail-to-text solutions and growth in our professional services for the automotive markets. As a percentage of total revenue, professional services and hosting revenue decreased 2.5 percentage points as compared to the corresponding period in the prior year, primarily due to the strong growth in product and licensing revenue relative to professional services and hosting revenue.

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Maintenance and Support Revenue

Maintenance and support revenue primarily consists of technical support and maintenance services. The following table shows maintenance and support revenue, in dollars and as a percentage of total revenue (dollars in millions):

	Three Months Ended June 30,		Dollar	Percent	Nine Months Ended June 30,		Dollar	Percent
	2010	2009	Change	Change	2010	2009	Change	Change
Maintenance and support revenue	$ 46.5	$ 42.7	$ 3.8	8.9%	$ 136.2	$ 122.9	$ 13.3	10.8%
As a percentage of total revenue	17.0%	17.7%			16.8%	17.9%		

The increase in maintenance and support revenue for the three months ended June 30, 2010, as compared to the three months ended June 30, 2009, consisted primarily of a $2.3 million increase in Mobile-Enterprise revenue, driven by continued organic growth, and a $1.1 million increase in Imaging revenue primarily due to contributions from our acquisition of X-Solutions and growth in sales of our core imaging products.

The increase in maintenance and support revenue for the nine months ended June 30, 2010, as compared to the nine months ended June 30, 2009, consisted primarily of a $7.8 million increase in Mobile-Enterprise revenue, driven by continued organic growth, and a $3.6 million increase related to the expansion of our current installed base of Healthcare-Dictation solutions.

COSTS AND EXPENSES

Cost of Product and Licensing Revenue

Cost of product and licensing revenue primarily consists of material and fulfillment costs, manufacturing and operations costs and third-party royalty expenses. The following table shows cost of product and licensing revenue, in dollars and as a percentage of product and licensing revenue (dollars in millions):

	Three Months Ended June 30,		Dollar	Percent	Nine Months Ended June 30,		Dollar	Percent
	2010	2009	Change	Change	2010	2009	Change	Change
Cost of product and licensing revenue	$ 10.9	$ 8.4	$ 2.5	29.8%	$ 34.2	$ 26.2	$ 8.0	30.5%
As a percentage of product and licensing revenue	10.0%	9.6%			10.2%	10.1%		

The increase in cost of product and licensing revenue for the three and nine months ended June 30, 2010, as compared to the same periods ended June 30, 2009, was primarily due to increased costs as a result of growth in our Healthcare-Dictation and Imaging product and licensing revenues. Gross margins relative to our product and licensing revenue remained relatively constant across all periods presented.

Cost of Professional Services and Hosting Revenue

Cost of professional services and hosting revenue primarily consists of compensation for consulting personnel, outside consultants and overhead, as well as the hardware and communications fees that support our hosted, on-

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demand solutions. The following table shows cost of professional services and hosting revenue, in dollars and as a percentage of professional services and hosting revenue (dollars in millions):