Nuance Communications, Inc.
Form 10-Q
August 09, 2011

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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, 2011**
	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 *(State or Other jurisdiction of incorporation or organization)*	**94-3156479** *(I.R.S. Employer Identification No.)*
1 Wayside Road **Burlington, Massachusetts** *(Address of principal executive offices)*	**01803** *(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, 2011, was 305,586,374.

NUANCE COMMUNICATIONS, INC.

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NUANCE COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2011	2010	2011	2010
	(Unaudited) (In thousands, except per share amounts)			
Revenues:				
Product and licensing	$ 152,745	$ 108,840	$ 428,181	$ 335,228
Professional services and hosting	125,347	117,875	377,078	337,798
Maintenance and support	50,817	46,488	146,441	136,159
Total revenues	328,909	273,203	951,700	809,185
Cost of revenues:				
Product and licensing	15,820	10,901	47,950	34,194
Professional services and hosting	83,301	71,353	248,003	206,349
Maintenance and support	8,836	7,631	26,645	23,335
Amortization of intangible assets	13,087	11,893	40,541	35,095
Total cost of revenues	121,044	101,778	363,139	298,973
Gross profit	207,865	171,425	588,561	510,212
Operating expenses:				
Research and development	42,245	38,916	129,898	113,797
Sales and marketing	73,336	67,219	225,817	196,680
General and administrative	35,901	29,887	104,271	88,643
Amortization of intangible assets	20,972	21,459	65,221	65,786
Acquisition-related costs, net	8,595	6,125	13,910	26,892
Restructuring and other charges, net	864	3,257	5,343	16,244
Total operating expenses	181,913	166,863	544,460	508,042
Income from operations	25,952	4,562	44,101	2,170
Other income (expense):				
Interest income	727	171	2,213	780
Interest expense	(8,749)	(9,971)	(26,814)	(30,380)
Other income (expense), net	301	5,539	8,865	10,685
Income (loss) before income taxes	18,231	301	28,365	(16,745)
(Benefit) provision for income taxes	(23,390)	1,831	(14,982)	4,459
Net income (loss)	$ 41,621	$ (1,530)	$ 43,347	$ (21,204)

Net income (loss) per share:				
Basic	$ 0.14	$ (0.01)	$ 0.14	$ (0.07)
Diluted	$ 0.13	$ (0.01)	$ 0.14	$ (0.07)
Weighted average common shares outstanding:				
Basic	303,100	291,610	300,846	285,202
Diluted	317,802	291,610	314,791	285,202

See accompanying notes.

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NUANCE COMMUNICATIONS, INC.

CONSOLIDATED BALANCE SHEETS

	June 30, 2011 (Unaudited)	September 30, 2010
	(In thousands, except per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 446,981	$ 516,630
Restricted cash (Note 9)	7,212	24,503
Marketable securities	36,617	5,044
Accounts receivable, less allowances for doubtful accounts of $5,721 and $6,301	247,972	217,587
Acquired unbilled accounts receivable	914	7,412
Prepaid expenses and other current assets	79,339	70,466
Total current assets	819,035	841,642
Land, building and equipment, net	79,623	62,083
Marketable securities		28,322
Goodwill	2,318,555	2,077,943
Intangible assets, net	757,599	685,865
Other assets	75,375	73,844
Total assets	$ 4,050,187	$ 3,769,699
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt and capital leases	$ 6,909	$ 7,764
Contingent and deferred acquisition payments	34,712	2,131
Accounts payable	82,235	78,616
Accrued expenses and other current liabilities	157,632	151,621
Deferred revenue	183,455	142,340
Total current liabilities	464,943	382,472
Long-term portion of debt and capital leases	852,444	851,014
Deferred revenue, net of current portion	81,502	76,598
Deferred tax liability	73,966	63,731
Other liabilities	114,548	98,688
Total liabilities	1,587,403	1,472,503
Commitments and contingencies (Notes 5 and 18)		
Stockholders equity:		
	4,631	4,631

Series B preferred stock, $0.001 par value; 15,000 shares authorized; 3,562 shares issued and outstanding (liquidation preference $4,631)		
Common stock, $0.001 par value; 560,000 shares authorized; 307,958 and 301,623 shares issued and 304,207 and 297,950 shares outstanding	308	302
Additional paid-in capital	2,681,024	2,581,901
Treasury stock, at cost (3,751 and 3,673 shares)	(16,788)	(16,788)
Accumulated other comprehensive income	31,617	8,505
Accumulated deficit	(238,008)	(281,355)
Total stockholders equity	2,462,784	2,297,196
Total liabilities and stockholders equity	$ 4,050,187	$ 3,769,699

See accompanying notes.

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NUANCE COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended June 30, 2011	2010
	(Unaudited) (In thousands)	
Cash flows from operating activities:		
Net income (loss)	$ 43,347	$ (21,204)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	125,719	116,738
Stock-based compensation	109,505	72,868
Non-cash interest expense	9,524	9,746
Non-cash restructuring and other expense		6,833
Deferred tax provision	(35,727)	(2,321)
Other	4,259	1,671
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	(3,679)	(13,023)
Prepaid expenses and other assets	(17,095)	(4,869)
Accounts payable	(9,999)	(3,960)
Accrued expenses and other liabilities	(9,950)	(7,825)
Deferred revenue	43,603	30,044
Net cash provided by operating activities	259,507	184,698
Cash flows from investing activities:		
Capital expenditures	(24,267)	(16,284)
Payments for acquisitions, net of cash acquired	(319,299)	(155,882)
Payments for acquired technology	(715)	(14,850)
Payments for equity investment		(14,970)
Purchases of marketable securities	(10,776)	
Proceeds from sales of marketable securities	6,650	
Change in restricted cash balances	17,184	(22,070)
Net cash used in investing activities	(331,223)	(224,056)
Cash flows from financing activities:		
Payments of debt and capital leases	(5,864)	(6,376)
Payments of other long-term liabilities	(7,794)	(7,319)
Proceeds on settlement of share-based derivatives, net	9,414	6,391
Excess tax benefits on employee equity awards	8,220	
Proceeds from issuance of common stock, net of issuance costs		12,350
Proceeds from issuance of common stock from employee stock plans	21,712	22,832
Cash used to net share settle employee equity awards	(30,027)	(18,040)

Net cash (used in) provided by financing activities	(4,339)	9,838
Effects of exchange rate changes on cash and cash equivalents	6,406	(5,444)
Net decrease in cash and cash equivalents	(69,649)	(34,964)
Cash and cash equivalents at beginning of period	516,630	527,038
Cash and cash equivalents at end of period	$ 446,981	$ 492,074

See accompanying notes.

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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.

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, 2010. Interim results are not necessarily indicative of the results that may be expected for a full year.

2. Summary of Significant Accounting Policies

With the exception of the adoption of the accounting pronouncements discussed below related to revenue recognition, we have made no changes to the significant accounting policies disclosed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2010. We have updated our disclosures on collaboration agreements to reflect activity in the current period.

Accounting for collaboration agreements

In June 2011, we entered into an agreement with a large healthcare provider to acquire certain data to be used in a joint development project in exchange for $10 million, $3.5 million of which was due on June 30, 2011. In addition, under the terms of the arrangement we will be reimbursed for certain research and development costs related to specified product development projects with the objective of commercializing the resulting products. All intellectual property derived from these research and development efforts will be owned by us. Upon product introduction, we will pay royalties to this party based on the actual sales. At the end of 5 years, the party can elect to continue with the arrangement, receiving royalties on future sales, or receive a buy-out payment from us and forego future royalties. The buy-out payment is calculated based on a number of factors including the net cash flows received and paid by the parties, as well as a minimum return on those net cash flows.

As of the execution of the above arrangement, we have other arrangements where we have sold and will continue to sell our products and services to this party. As a result, under the guidance of ASC 605, Revenue Recognition, we are required to reduce the revenue recognized by the amount we pay to this customer, up to our historical revenue recorded from them. We have therefore reduced reported revenue by $3.5 million for the three months ended June 30, 2011.

The above development arrangement will be accounted for in accordance with ASC 730, Research and Development. Accordingly, any buy-out obligation will be recorded as a liability and any reimbursement of the research and development costs in excess of the buy-out obligation will be recorded as an offset to research and development costs. Royalties paid to this party upon commercialization of any products from these development efforts will be recorded as a reduction to revenue in accordance with ASC 605. During the quarter ended June 30, 2011, $4.6 million of expense reimbursement has been recorded as a reduction in research and development expense.

Adoption of new accounting standards

Effective October 1, 2010, we adopted the provisions in the Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable*

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Revenue Arrangements (ASU 2009-13) and ASU 2009-14. *Software (Topic 985): Certain Revenue Arrangements that Include Software Elements* (ASU 2009-14). The provisions of ASU 2009-13 apply to arrangements that are outside the scope of software revenue recognition guidance and amend Accounting Standards Codification (ASC) Topic 605 to (1) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the consideration allocated; (2) require an entity to allocate revenue in an arrangement using the best estimated selling prices (BESP) of deliverables if a vendor does not have vendor-specific objective evidence (VSOE) or third-party evidence (TPE) of selling price; and (3) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method. ASU 2009-14 modifies the scope of ASC Topic 985 to remove industry specific revenue accounting guidance for software and software related transactions, tangible products containing software components and non-software components that function together to deliver the product s essential functionality. The adoption of these provisions did not have a material impact on our consolidated financial statements.

ASU 2009-13 does not generally change the units of accounting for our revenue transactions. For multiple-element arrangements that contain both software and non-software elements such as our hosted offerings, we allocate revenue to software or software related elements and any non-software elements separately based on the selling price hierarchy. We determine the selling price for each deliverable using VSOE of selling price, if it exists, or TPE of selling price. If neither VSOE nor TPE of selling price exist for a deliverable, we use our BESP for that deliverable. Revenue allocated to each element is then recognized when the basic revenue recognition criteria are met for each element.

To determine the selling price in multiple-element arrangements, we establish VSOE of fair value for the majority of our post-contract customer support, professional services, and training based on historical stand-alone sales to third-parties. Typically, we are unable to determine TPE of selling price and therefore when neither VSOE nor TPE of selling price exist, we use BESP for the purposes of allocating the arrangement consideration. We determine BESP for a product or service by considering multiple factors including, but not limited to, major product groupings, market conditions, competitive landscape, price list and discounting practice.

Recently Issued Accounting Standards

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income. This ASU intends to enhance comparability and transparency of other comprehensive income components. The guidance provides an option to present total comprehensive income, the components of net income and the components of other comprehensive income in a single continuous statement or two separate but consecutive statements. This ASU eliminates the option to present other comprehensive income components as part of the statement of changes in shareowners equity. The provisions of this ASU will be applied retrospectively for interim and annual periods beginning after December 15, 2011. Early application is permitted. ASU 2011-05 impacts disclosure only and therefore, is not expected to, have a material impact on our financial statements.

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

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

impacts disclosure only and therefore, did not, and is not expected to, have a material impact on our financial statements.

In December 2010, the FASB issued ASU No. 2010-28, *Intangibles Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*. ASU 2010-28 is effective for fiscal years beginning after December 15, 2010 and amends the criteria for performing Step 2 of the goodwill impairment test for reporting units with zero or negative carrying amounts and requires performing Step 2 if qualitative factors indicate that it is more likely than not that a goodwill impairment exists. We do not believe that this will have a material impact on our consolidated financial statements.

3. Comprehensive Income (Loss)

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2011	**2010**	**2011**	**2010**
Net income (loss)	$ 41,621	$ (1,530)	$ 43,347	$ (21,204)
Other comprehensive income (loss):				
Foreign currency translation adjustment	6,148	(19,488)	22,893	(31,510)
Unrealized (loss) gain on cash flow hedge derivatives	(465)	690	54	2,228
Unrealized gain on marketable securities, net	28		26	
Recognition of pension loss amortization	9		139	
Other comprehensive income (loss)	5,720	(18,798)	23,112	(29,282)
Comprehensive income (loss)	$ 47,341	$ (20,328)	$ 66,459	$ (50,486)

4. Business Acquisitions

Fiscal 2011 Acquisitions

On June 15, 2011, we acquired all of the outstanding capital stock of Equitrac Corporation (Equitrac), a leading provider of print management solutions, for cash consideration of approximately $162 million. 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 Equitrac have been included in our results of operations from June 15, 2011.

On June 16, 2011, we acquired all of the outstanding capital stock of SVOX A.G. (SVOX), a German based seller of speech recognition, dialog, and text-to-speech software products for the automotive, mobile and consumer electronics industries. Total purchase consideration was 87.0 million which consists of cash consideration of 57.0 million ($80.9 million based on the exchange rate as of the date of acquisition) and a deferred acquisition payment of 30.0 million ($43.0 million based on the exchange rate as of the date of acquisition). The deferred acquisition payment is payable in cash or shares of our common stock, at our option;   8.3 million of the deferred acquisition payment is due on June 16, 2012 and the remaining   21.7 million is due on December 31, 2012. 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 SVOX have been included in our results of operations from June 16, 2011.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	Equitrac	SVOX
Total purchase consideration:		
Cash	$ 161,950	$ 80,919
Deferred acquisition payment		42,990
Total purchase consideration	$ 161,950	$ 123,909
Allocation of the purchase consideration:		
Cash	$ 115	$
Accounts receivable(a)	10,724	910
Inventory	2,462	
Goodwill	87,705	92,478
Identifiable intangible assets(b)	91,900	42,165
Other assets	10,617	2,728
Total assets acquired	203,523	138,281
Current liabilities	(3,262)	(9,542)
Deferred tax liability	(38,311)	(4,830)
Total liabilities assumed	(41,573)	(14,372)
Net assets acquired	$ 161,950	$ 123,909

(a) Accounts receivable have been recorded at their estimated fair values, which consists of the gross accounts receivable assumed of $12.7 million, reduced by a fair value reserve of $1.1 million representing the portion of contractually owed accounts receivable which we do not expect to be collected.

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

	Equitrac		SVOX	
	Amount	Weighted Average Life (Years)	Amount	Weighted Average Life (Years)
Customer relationships	$ 55,800	15.0	$ 35,612	13.4
Core and completed technology	22,000	7.0	6,268	5.0

Trade name	14,100	10.0	285	3.0
Total	$ 91,900		$ 42,165	

Other Fiscal 2011 Acquisitions

During fiscal 2011, we acquired two additional businesses, primarily to expand our product offerings and enhance our technology base. The results of operations of these acquisitions have been included in our consolidated results from their respective acquisition dates. The total consideration for these acquisitions was $82.1 million, paid in cash. In allocating the total purchase consideration for these acquisitions based on estimated fair values, we preliminarily recorded $42.4 million of goodwill and $34.0 million of identifiable intangible assets. The allocations of the purchase consideration are based upon preliminary valuations and our estimates and assumptions are subject to change. Intangible assets acquired included primarily customer relationships and core and completed technology

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

with weighted average useful lives of 11.5 years. The acquisitions were stock acquisitions and the goodwill resulting from these transactions is not expected to be deductible for tax purposes.

Proforma Results

In addition to the acquisitions of Equitrac and SVOX discussed above, 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 following table shows unaudited pro forma results of operations as if we had acquired SpinVox, Equitrac and SVOX on October 1, 2009 (dollars in thousands, except per share amounts):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2011	**2010**	**2011**	**2010**
Revenue	$ 348,877	$ 287,521	$ 1,007,734	$ 865,305
Net income (loss)	39,857	(5,236)	34,564	(55,147)
Net income (loss) per share	$ 0.13	$ (0.02)	$ 0.11	$ (0.19)

We have not furnished pro forma financial information related to our other fiscal 2011 and 2010 acquisitions because such information is not material, individually or in the aggregate, to our financial results. The unaudited pro forma results of operations are not necessarily indicative of the actual results that would have occurred had the transactions actually taken place at the beginning of the periods indicated.

Acquisition-Related Costs, net

The components of acquisition-related costs, net are as follows (dollars in thousands):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2011	**2010**	**2011**	**2010**
Transition and integration costs	$ 453	$ 3,383	$ 1,506	$ 12,035
Professional service fees	7,775	3,079	11,107	14,933
Acquisition-related adjustments	367	(337)	1,297	(76)
Total	$ 8,595	$ 6,125	$ 13,910	$ 26,892

The increase in acquisition-related costs, net for the three months ended June 30, 2011, as compared to the three months ended June 30, 2010, was primarily driven by a reduction in transition and integration costs offset by an increase in professional service fees. For the three months ended June 30, 2010, transition and integration costs consisted primarily of costs associated with transitional employees from our acquisitions of SpinVox and eCopy. For the three months ended June 30, 2011, professional service fees consisted of expenses related to our third quarter 2011 acquisitions.

The decrease for the nine months ended June 30, 2011, as compared to the nine months ended June 30, 2010, was primarily driven by a reduction in transition and integration costs and professional services fees. For the nine months ended June 30, 2010, transition and integration costs consisted primarily of the costs associated with transitional employees from our acquisitions of SpinVox and eCopy; professional services consisted of expenses related to our acquisition of SpinVox in December 2009 and approximately $2.2 million that had been capitalized as of September 30, 2009 related to transaction costs incurred in prior periods that was required to be expensed upon our adoption of ASC 805, *Business Combinations*, in fiscal 2010.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Contingent Acquisition Payments

Earn-out Payments

For business combinations occurring subsequent to the adoption of ASC 805 in fiscal 2010, the fair value of any contingent consideration is established at the acquisition date and included in the total purchase price. The contingent consideration is then adjusted to fair value as an increase or decrease in current earnings in each reporting period. 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 our acquisition of Vocada, Inc. (Vocada) in November 2007, we agreed to make contingent earn-out payments of up to $21.0 million upon the achievement of certain financial targets measured over defined periods through December 31, 2010, in accordance with the merger agreement. We have notified the former shareholders of Vocada that the financial targets were not achieved. In December 2010, the former shareholders filed a demand for arbitration in accordance with their rights under the merger agreement. At June 30, 2011, we have not recorded any obligation relative to these earn-out provisions.

In connection with the acquisition of Commissure, Inc. (Commissure) in September 2007, 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. In February 2011, we paid $1.0 million upon determination of the final earn-out achievement and recorded the payment as additional purchase price allocated to goodwill.

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 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.

During the nine months ended June 30, 2011, the last remaining escrowed amounts accounted for under previous accounting guidance expired. Payments totaling $5.2 million were released to former shareholders of X-Solutions Group B.V. and eCopy and were recorded as an increase to goodwill during the period.

6. Goodwill and Intangible Assets

The changes in the carrying amount of goodwill and intangible assets for the nine months ended June 30, 2011, are as follows (dollars in thousands):

	Goodwill	Intangible Assets
Balance as of September 30, 2010	$ 2,077,943	$ 685,865
Acquisitions	222,545	171,556
Purchase accounting adjustments	4,366	648
Amortization		(105,762)
Effect of foreign currency translation	13,701	5,292
Balance as of June 30, 2011	$ 2,318,555	$ 757,599

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the nine months ended June 30, 2011, in addition to the businesses acquisitions described in Note 4 we made several purchases of intellectual property. Purchase accounting adjustments to goodwill recorded during the nine months ended June 30, 2011, included $5.2 million of releases of escrow cash related to our fiscal 2009 acquisitions. This increase in goodwill was partially offset by a $1.4 million reduction resulting from the finalization of the Spinvox purchase accounting.

7. Financial Instruments and Hedging Activities

Cash Flow Hedges

Forward Currency Contracts

We enter into foreign currency contracts to hedge the variability of cash flows in Canadian Dollars (CAD) and Hungarian Forints (HUF) which are designated as cash flow hedges. These contracts settle monthly through October 2011. At June 30, 2011 and September 30, 2010, the notional value and the aggregate cumulative unrealized gains on the outstanding contracts were as follows:

	Notional Value		Aggregate Cumulative Unrealized Gains	
	June 30, 2011	September 30, 2010	June 30, 2011	September 30, 2010
Canadian Dollars	$ 1,547	$ 13,032	$ 125	$ 286
Hungarian Forints	636	4,564	155	443
Total contracts designated as cash flow hedges	$ 2,183	$ 17,596	$ 280	$ 729

Other Derivatives not Designated as Hedges

Forward Currency Contracts

We operate our business in countries throughout the world and transact business in various foreign currencies. Our foreign currency exposures typically arise from transactions denominated in currencies other than the local functional currency of our operations. During fiscal 2011, we commenced a program that primarily utilizes foreign currency forward contracts to offset the risks associated with foreign currency denominated assets and liabilities. We established this program so that gains and losses from remeasurement or settlement of these assets and liabilities are offset by gains or losses on the foreign currency forward contracts thus mitigating the risks and volatility associated with our foreign currency transactions. Generally, we enter into contracts with terms of 30 days or less, and at June 30, 2011 we had outstanding contracts with a total notional value of $165.4 million.

We have not designated these forward contracts as hedging instruments pursuant to ASC 815, *Derivatives and Hedging* and accordingly, we recorded the fair value of these contracts at the end of each reporting period in our consolidated balance sheet, with changes in the fair value recorded in earnings as other income (expense), net in our consolidated statement of operations. During the three and nine month periods ended June 30, 2011, we recorded losses of $0.2 million and $0.7 million, respectively, associated with these contracts.

Security Price Guarantees

From time to time we enter into agreements that allow us to issue shares of our common stock as part or all of the consideration related to partnering and technology acquisition activities. Generally these shares are issued subject to security price guarantees which are accounted for as derivatives. We have determined that these instruments would not be considered equity instruments if they were freestanding. The security price guarantees require payment from either us to a third party, or from a 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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the fair value of these security price guarantees are reported in earnings in each period as other income (expense), net. During the three and nine months ended June 30, 2011, we recorded gains of $0.4 million and $10.8 million, respectively, associated with these contracts. We received cash totaling $10.0 million to settle certain of these contracts during the three months ended June 30, 2011.

The following table provides a summary of the fair value of our derivative instruments as of June 30, 2011 and September 30, 2010 (dollars in thousands):

Description	Balance Sheet Classification	Fair Value June 30, 2011	Fair Value September 30, 2010
Derivatives Not Designated as Hedges:			
Foreign currency contracts	Prepaid expenses and other current assets	$ 505	$ 767
Foreign currency contracts	Accrued expenses and other current liabilities	(463)	
Security price guarantees	Prepaid expenses and other current assets	395	
Security price guarantees	Accrued expenses and other current liabilities		(982)
Net asset (liability) value of non-hedge derivative instruments		$ 437	$ (215)
Derivatives Designated as Hedges:			
Foreign currency contracts	Prepaid expenses and other current assets	$ 280	$ 729
Interest rate swaps	Accrued expenses and other current liabilities		(503)
Net asset value of hedge derivative instruments		$ 280	$ 226

The following tables summarize the activity of derivative instruments for the three and nine months ended June 30, 2011 and 2010, respectively (dollars 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

	2011	2010	Accumulated OCI into Income (Effective Portion)	2011	2010
Foreign currency contracts	$ 16	$ (321)	Other income (expense), net	$ 481	$ (98)
Interest rate swaps	$	$ 1,109	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)		
	2011	2010		2011	2010
Foreign currency contracts	$ 529	$ (99)	Other income (expense), net	$ 978	$ (190)
Interest rate swaps	$	$ 2,517	Interest expense	$ (503)	$

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Derivatives Not Designated as Hedges

		Amount of Gain (Loss) Recognized in Income			
		Three Months Ended June 30,		Nine Months Ended June 30,	
	Location of Gain (Loss) Recognized in Income	2011	2010	2011	2010
Foreign currency contracts	Other income (expense), net	$ (217)	$	$ (675)	$
Security price guarantees	Other income (expense), net	$ 395	$ (1,044)	$ 10,844	$ 3,664

Other Financial Instruments

Financial instruments, including cash equivalents, restricted cash, marketable securities, accounts receivable, accounts payable and derivative instruments, are carried in the consolidated financial statements at amounts that approximate their fair value.

The fair value of our long-term debt was estimated to be $963.3 million and $902.2 million at June 30, 2011 and September 30, 2010, respectively. The increase in the fair value is primarily related to the convertible debt, reflecting the increase in the underlying stock price during the period. 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 the long-term debt issues will continue to vary each period based on fluctuations in market interest rates, changes to our credit ratings and, for the outstanding convertible debt, changes in our stock price. These fluctuations may have little to no correlation to our reported debt balances. 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 at each respective reporting date were estimated using the averages of the June 30, 2011 and September 30, 2010 bid and ask trading quotes. 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, 2011 and September 30, 2010.

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, *Fair Value Measures and Disclosures,* 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.

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Assets and liabilities measured at fair value on a recurring basis at June 30, 2011 and September 30, 2010 consisted of the following (dollars in thousands):

	June 30, 2011			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Money market funds(a)	$ 231,198	$	$	$ 231,198
Time Deposits(b)		98,607		98,607
US government agency securities(a)	1,000			1,000
Marketable securities, $36,562 at cost(b)		36,617		36,617
Foreign currency exchange contracts(b)		785		785
Security price guarantees(c)		395		395
Total assets at fair value	$ 232,198	$ 136,404	$	$ 368,602
Liabilities:				
Foreign currency exchange contracts(b)		463		463
Contingent earn-out(d)			2,115	2,115
Total liabilities at fair value	$	$ 463	$ 2,115	$ 2,578

	September 30, 2010			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Money market funds(a)	$ 470,845	$	$	$ 470,845
US government agency securities(a)	1,000			1,000
Marketable securities, $33,337 at cost(b)		33,366		33,366
Foreign currency exchange contracts(b)		1,496		1,496
Total assets at fair value	$ 471,845	$ 34,862	$	$ 506,707
Liabilities:				
Security price guarantees(c)	$	$ 982	$	$ 982
Interest rate swaps(e)		503		503
Contingent earn-out(d)			724	724
Total liabilities at fair value	$	$ 1,485	$ 724	$ 2,209

(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 time deposits, marketable securities and foreign currency exchange contracts is based on the most recent observable inputs for similar 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

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the acquired entity, as well as our common stock price since the contingent consideration arrangement is payable in shares of our common stock.

(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.

The changes in the fair value of contingent earn-out liabilities during the three and nine months ended June 30, 2011 are as follows (dollars in thousands):

	Three Months Ended June 30, 2011	Nine Months Ended June 30, 2011
Balance at beginning of period	$ 1,679	$ 724
Charges to acquisition-related costs, net	436	1,391
Balance as of June 30, 2011	$ 2,115	$ 2,115

Earn-out payments are generally payable based on achieving certain financial targets during defined post-acquisition time periods as specified in the purchase and sale agreement for each acquisition. Changes in the fair value during the three and nine months ended June 30, 2011 resulted from improved revenue performance together with an increase in our stock price during the earn-out period.

9. Current Liabilities

Accrued expenses and other current liabilities consisted of the following (dollars in thousands):

	June 30, 2011	September 30, 2010
Compensation	$ 76,251	$ 56,047
Sales and marketing incentives(a)	17,174	40,780
Professional fees	13,187	9,908
Accrued business combination costs	10,038	10,197
Sales and other taxes payable	9,091	5,211
Cost of revenue related liabilities	9,325	10,028
Acquisition costs and liabilities	8,299	4,970
Income taxes payable	2,960	4,357
Security price guarantee		1,034
Other	11,307	9,089
Total	$ 157,632	$ 151,621

(a) The decrease in accrued sales and marketing incentives was driven by an   18.0 million ($23.4 million equivalent) payment in December 2010 for a fixed obligation assumed in connection with our acquisition of SpinVox. The related   18.0 million of restricted cash was placed in an irrevocable standby letter of credit account at the end of fiscal year 2010 and was released upon satisfaction of the liability in December 2010. At June 30, 2011, we have an additional   5.0 million ($7.2 million equivalent) of restricted cash that has been placed in an irrevocable standby letter of credit for a related liability.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Deferred Revenues

Deferred revenue consisted of the following (dollars in thousands):

	June 30, 2011	September 30, 2010
Current Liabilities:		
Deferred maintenance revenue	$ 98,071	$ 90,969
Unearned revenue	85,384	51,371
Total current deferred revenue	$ 183,455	$ 142,340
Long-term Liabilities:		
Deferred maintenance revenue	$ 20,274	$ 12,902
Unearned revenue	61,228	63,696
Total long-term deferred revenue	$ 81,502	$ 76,598

Deferred maintenance revenue consists of prepaid fees received for post-contract customer support for our products, including telephone support and the right to receive unspecified upgrades/enhancements on a when-and-if-available basis. Unearned revenue includes upfront fees for setup and implementation activities related to hosted offerings; certain software arrangements for which we do not have fair value of post-contract customer support, resulting in ratable revenue recognition for the entire arrangement on a straight-line basis; and fees in excess of estimated earnings on percentage-of-completion service contracts.

The increase in the deferred maintenance revenue is primarily related to an increase in Imaging maintenance and support as well as an increase in Enterprise application maintenance. Unearned revenue increased as a result of set-up fees on new hosting arrangements that will be recognized ratably over the longer of the contract lives, or the expected lives of the customer relationship as well as billings in excess of revenues earned on several large professional service implementation projects.

11. Business Combination Costs

The activity for the nine months ended June 30, 2011, relating to all facilities and personnel recorded in accrued business combination costs, is as follows (dollars in thousands):

	Facilities	Personnel	Total
Balance at September 30, 2010	$ 23,871	$ 159	$ 24,030
Charged to restructuring and other charges, net	(129)	(100)	(229)
Charged to interest expense	662		662

Cash payments, net of sublease receipts	(8,616)	(59)	(8,675)
Balance at June 30, 2011	$ 15,788	$	$ 15,788

	June 30, 2011	**September 30, 2010**
Reported as:		
Other current liabilities	$ 10,038	$ 10,197
Other liabilities	5,750	13,833
Total	$ 15,788	$ 24,030

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12. Restructuring and Other Charges, net

The following table sets forth the nine months ended June 30, 2011 accrual activity relating to restructuring and other charges (dollars in thousands):

	Personnel	Facilities	Other	Total
Balance at September 30, 2010	$ 1,838	$ 283	$	$ 2,121
Restructuring and other charges, net	3,854	1,460	258	5,572
Non-cash adjustment	208		(165)	43
Cash payments	(4,629)	(852)	(93)	(5,574)
Balance at June 30, 2011	$ 1,271	$ 891	$	$ 2,162

For the nine months ended June 30, 2011, we recorded net restructuring and other charges of $5.6 million, which included $3.9 million of severance and other costs related to the elimination of approximately 90 personnel across multiple functions worldwide, primarily within costs of sales, and $1.5 million related to facilities that we no longer occupy.

13. Credit Facilities and Debt

2.75% Convertible Debentures

We have $250 million of 2.75% convertible senior debentures due in August 2027. As of June 30, 2011, 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.

Credit Facility

We have a credit facility which originally consisted 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 revolving credit line was due in March 2012. The original provisions of the credit facility called for quarterly principal and interest payments on the term loans, with an original maturity in March 2013. In July 2011, we entered into agreements to amend and restate our existing Credit Facility. Of the approximately $638.5 million remaining Term Loan originally due March 31, 2013, lenders representing $486.9 million have elected to extend the maturity date three years to March 31, 2016. The remaining $151.6 million in term loans are due March 2013. In addition, lenders participating in the revolving credit facility have chosen to extend the maturity date by three years to March 31, 2015.

In conjunction with the amendment, the Credit Facility repayment terms were amended. Principal is due in four quarterly installments of 1% per annum through the original maturity date of March 2013, at which time the principal remaining on the unextended portion of the loans becomes payable. The table below details the new

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schedule of principal payments by fiscal year. If only the minimum required repayments are made, the annual aggregate principal amount of the term loans repaid would be as follows (dollars in thousands):

Year Ending September 30,	Amount
2011 (quarter ending September 30)	$ 1,596
2012	6,346
2013	154,494
2014	4,743
2015	4,696
2016	466,663
Total	$ 638,538

Under terms of the amendment, borrowings under the Credit Facility bear interest at a rate equal to the applicable margin plus, at our option, either (a) the base rate which is the higher of the corporate base rate of UBS AG, Stamford Branch, or the federal funds rate plus 0.50% per annum or (b) LIBOR (equal to (i) the British Bankers Association Interest Settlement Rates for deposits in U.S. dollars divided by (ii) one minus the statutory reserves applicable to such borrowing). The applicable margin for the borrowings is as follows:

Description	Base Rate Margin	LIBOR Margin
Term loans due March 2013	0.75% - 1.50%(a)	1.75% - 2.50%(a)
Term loans due March 2016	2.00%	3.00%
Revolving facility due March 2015	1.25% - 2.25%(b)	2.25% - 3.25%(b)

(a) The margin is determined based on our leverage ratio at the date the interest rates are reset on the Term Loans.

(b) The margin is determined based on our credit rating at the date the interest rates are reset on the Revolving Loans

As of June 30, 2011 (prior to the amendment), based on our leverage ratio, the applicable margin for our term loan was 0.75% for base rate borrowings and 1.75% for LIBOR-based borrowings. This results in an effective interest rate of 1.95%. No payments under the excess cash flow sweep provision were due in the first quarter of fiscal 2011 as no excess cash flow, as defined, was generated in fiscal 2010. 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.

As of June 30, 2011, $638.5 million remained outstanding under the term loans, there were $15.7 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, 2011, we were in compliance with the covenants under the Credit Facility.

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14. Net Income (Loss) Per Share

The following table sets forth the computation for basic and diluted net income (loss) per share for the three and nine months ended June 30, 2011 and 2010. (amounts in thousands, except per share amounts):

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Nine Months Ended June 30, 2011	Nine Months Ended June 30, 2010
Numerator:				
Basic				
Net income (loss) available to common stockholders basic	$ 41,621	$ (1,530)	$ 43,347	$ (21,204)
Diluted				
Net income (loss) available to common stockholders diluted	$ 41,621	$ (1,530)	$ 43,347	$ (21,204)
Denominator:				
Basic				
Weighted average common shares outstanding	303,100	291,610	300,846	285,202
Diluted				
Weighted average common shares outstanding basic	303,100	291,610	300,846	285,202
Weighted average effect of dilutive common equivalent shares:				
Assumed conversion of Series B Preferred Stock	3,562		3,562	
Employee stock compensation plan	8,538		8,704	
Warrants	1,793		1,485	
Other contingently issuable shares	809		194	
Weighted average common shares outstanding diluted	317,802	291,610	314,791	285,202
Net income (loss) per share:				
Basic	$ 0.14	$ (0.01)	$ 0.14	$ (0.07)
Diluted	$ 0.13	$ (0.01)	$ 0.14	$ (0.07)

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 3.6 million and 3.5 million shares for the three and nine months ended June 30, 2011, respectively, and 19.9 million and 21.8 million shares for the three and nine months ended June 30, 2010, respectively, have been excluded from the computation of diluted net income (loss) per share because their inclusion would be anti-dilutive.

15. Stockholders Equity

We have, from time to time, entered into stock and warrant agreements with Warburg Pincus. In connection with these agreements, we granted Warburg Pincus the right to request that we use commercially reasonable efforts to register some or all of the shares of common stock issued to them pursuant to the purchase agreements, including

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shares of common stock underlying the warrants. At June 30, 2011, Warburg Pincus holds the following warrants to purchase shares of our common stock:

Issuance Date	Price per Share	Total Shares	Expiration Date
January 29, 2009	$ 11.57	3,862,422	January 29, 2013
May 20, 2008	20.00	3,700,000	May 20, 2012

16. 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,	
	2011	2010	2011	2010
Cost of product and licensing	$ 2	$ 7	$ 29	$ 25
Cost of professional services and hosting	5,764	2,612	20,514	8,173
Cost of maintenance and support	518	165	1,545	582
Research and development	5,280	2,282	18,188	6,731
Sales and marketing	10,341	12,516	32,748	29,813
General and administrative	11,883	10,512	36,481	27,544
Total	$ 33,788	$ 28,094	$ 109,505	$ 72,868

Included in stock-based compensation for the three and nine months ended June 30, 2011 is $11.0 million and $24.1 million, respectively, of expense related to awards that will be made as part of the fiscal 2011 annual bonus plan to employees. The annual bonus pool is determined by management and approved by the Compensation Committee of the Board of Directors based on financial performance targets approved at the beginning of the year. If these targets are achieved, the awards will be settled in shares based on the total bonus earned and the grant date fair value of the shares awarded to each employee.

Stock Options

The table below summarizes activity relating to stock options for the nine months ended June 30, 2011:

	Weighted	Weighted Average

	Number of Shares		Average Exercise Price	Remaining Contractual Term		Aggregate Intrinsic Value(1)
Outstanding at September 30, 2010	10,703,237	$	8.44			
Granted	1,000,000	$	16.44			
Exercised	(2,448,623)	$	6.33			
Forfeited	(89,553)	$	12.81			
Expired	(63,401)	$	14.99			
Outstanding at June 30, 2011	9,101,660	$	9.79	3.4 years	$	106.3 million
Exercisable at June 30, 2011	6,917,436	$	8.21	2.6 years	$	91.7 million
Exercisable at June 30, 2010	8,021,090	$	6.94	2.9 years	$	65.9 million

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(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, 2011 ($21.47) and the exercise price of the underlying options.

As of June 30, 2011, the total unamortized fair value of stock options was $5.9 million with a weighted average remaining recognition period of 0.8 years. A summary of weighted-average grant-date fair value of stock options granted and intrinsic value of stock options exercised is as follows:

	Nine Months Ended June 30,	
	2011	2010
Weighted-average grant-date fair value per share	$ 6.13	$ 5.90
Total intrinsic value of stock options exercised (in millions)	$ 32.9	$ 34.1

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 during the nine months ended June 30, 2011 and 2010 were calculated using the following weighted-average assumptions:

	Nine Months Ended June 30,	
	2011	2010
Dividend yield	0.0%	0.0%
Expected volatility	46.1%	50.9%
Average risk-free interest rate	1.2%	2.4%
Expected term (in years)	4.1	4.2

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 ended June 30, 2011:

	Number of Shares Underlying Restricted Units Contingent Awards	Number of Shares Underlying Restricted Units Time-Based Awards
Outstanding at September 30, 2010	2,867,840	7,795,114
Granted	1,329,988	3,521,636
Earned/released	(1,296,018)	(3,273,826)

Forfeited		(360,009)		(557,123)
Outstanding at June 30, 2011		2,541,801		7,485,801
Weighted average remaining contractual term of outstanding Restricted Units		1.0 years		1.1 years
Aggregate intrinsic value of outstanding Restricted Units(1)	$	54.6 million	$	160.7 million
Restricted Units vested and expected to vest		2,383,251		6,961,901
Weighted average remaining contractual term of Restricted Units vested and expected to vest		1.0 years		1.1 years
Aggregate intrinsic value of Restricted Units vested and expected to vest(1)	$	51.2 million	$	149.5 million

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(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, 2011 ($21.47) and the exercise price of the underlying Restricted Units.

The purchase price for vested Restricted Units is $0.001 per share. As of June 30, 2011, unearned stock-based compensation expense related to all unvested Restricted Units is $121.5 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 and intrinsic value of all Restricted Units vested is as follows:

	Nine Months Ended, June 30,	
	2011	2010
Weighted-average grant-date fair value per share	$ 17.91	$ 15.59
Total intrinsic value of shares vested (in millions)	$ 81.8	$ 65.2

17. Income Taxes

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2011	2010	2011	2010
Income (loss) before income taxes	$ 18,231	$ 301	$ 28,365	$ (16,745)
(Benefit) provision for income taxes	(23,390)	1,831	(14,982)	4,459
Effective tax rate	(128.3)%	608.3%	(52.8)%	(26.6)%

The change in the effective tax rate and the decrease in the income tax provision, was primarily related to a one-time tax benefit recorded in connection with the Equitrac acquisition. We recorded a deferred tax liability in purchase accounting allowing a release of our existing valuation reserve, resulting in the recognition of a tax benefit for the three and nine months ended June 30, 2011. This tax benefit was offset by the tax on U.S. profits in the three and nine months ended June 30, 2011.

At June 30, 2011 and September 30, 2010, the liability for income taxes associated with uncertain tax positions was $13.4 million and $12.8 million, respectively. The increase is primarily attributable to accrued interest. We do not expect a significant change in the amount of unrecognized tax benefits within the next twelve months

18. Commitments and Contingencies

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. These matters were concluded during the three months ended March 31, 2011. The resolution of these matters did not have a material impact on our financial statements or liquidity.

We do not believe that the final outcome of the above referenced 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

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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 Commitments

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.

19. Segment and Geographic Information and Significant Customers

We follow the provisions of ASC 280, *Segment Reporting*, which establishes standards for reporting information about operating 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 four customer-facing market groups that oversee the core markets where we conduct business. These groups are referred to as Healthcare, Mobile and Consumer, Enterprise and Imaging. These groups do not directly manage centralized or shared resources or make 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 regularly 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.

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2011	2010	2011	2010
Healthcare	$ 135,409	$ 113,523	$ 373,543	$ 324,880
Mobile and Consumer	91,613	66,292	270,842	208,153
Enterprise	68,536	71,006	211,900	217,306
Imaging	33,351	22,382	95,415	58,846
Total Revenue	$ 328,909	$ 273,203	$ 951,700	$ 809,185

No country outside of the United States provided greater than 10% of our total revenue for the three months and nine months ended June 30, 2011 and 2010. Revenue, classified by the major geographic areas in which our customers are located, was as follows (dollars in thousands):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2011	2010	2011	2010
United States	$ 237,423	$ 202,080	$ 701,374	$ 576,122
International	91,486	71,123	250,326	233,063
Total	$ 328,909	$ 273,203	$ 951,700	$ 809,185

No country outside of the United States held greater than 10% of our long-lived or total assets as of June 30, 2011 and September 30, 2010. Our non-current assets, including intangible assets and goodwill, were located as follows (dollars in thousands):

	June 30, 2011	September 30, 2010
United States	$ 2,633,100	$ 2,479,952
International	598,052	448,105
Total	$ 3,231,152	$ 2,928,057

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CAUTIONARY NOTE CONCERNING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q including the sections entitled Management s Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosure About Market Risk under Items 2 and 3, respectively, of Part I of this report, and the sections entitled Legal Proceedings, Risk Factors, and Unregistered Sales of Equity Securities and Use of Proceeds under Items 1, 1A and 2, respectively, of Part II of this report, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks, uncertainties and assumptions that, if they never materialize or if they prove incorrect, could cause our consolidated results to differ materially from those expressed or implied by such forward-looking statements. These forward-looking statements include predictions regarding:

- our future revenues, cost of revenues, 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 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 and elsewhere in this Quarterly Report on Form 10-Q.

You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. 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.

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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.

OVERVIEW

Business Overview

Nuance Communications, Inc. is a leading provider of voice and language solutions for businesses 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. 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.

Core Markets

Our technologies address our four core markets, each of which is described in greater detail below.

Healthcare. Our healthcare products and services enable our customers to automate manual functions, and manage information and workflows. A significant component of sales in our healthcare market are for on-demand solutions hosted by Nuance and priced by the volume of services used by the customer, primarily for healthcare information management. With these solutions, we provide software and labor to transcribe information dictated by healthcare providers that go into patient files, and to manage the associated workflows. The healthcare information management market is migrating away from unstructured, distributed files toward structured, computer-accessible, searchable files generally known as electronic medical records or EMRs. Our solutions address both the old unstructured files and EMRs, and we are able to provide technology and services that help our customers through this transition. In addition to healthcare information management, we provide solutions for areas such as radiology, diagnostics, critical test results management, mobile access to systems, and processing data contained in medical records. Trends in our healthcare business include a growing customer preference for hosted solutions, increasing interest in the use of mobile devices to access healthcare systems and records, and increasing international interest. We are also seeing increased demand for transactions which involve the sale and delivery of both software and non-software related services or products, which may benefit from the application of Financial Accounting Standards board (FASB) Accounting Standards Codification (ASC) 605, *Revenue Recognition.* Over the last several quarters, we have signed several new contracts for our hosted solutions, and the volume of lines processed in these services has steadily increased. We are investing to expand our product set to address these opportunities, expand our international capabilities, and reduce our time from contract signing to initiation of billable services.

Mobile and Consumer. The majority of sales in our mobile-consumer market are for voice recognition, text-to-speech and enhanced keyboard functionality that is embedded in a device (such as a cell phone, car or tablet computer) or installed on a personal computer. There is a growing trend toward supplementing those solutions with mobile connected services such as Internet search, dictation and transcription of voice messages, that are performed on hosted Nuance servers and accessed by mobile devices using the Internet or mobile telephony network, and also for applications that can be downloaded onto mobile devices. Trends in our mobile-consumer market also include device manufacturers requiring custom applications to deliver unique and differentiated products, broadening keyboard technologies to take advantage of touch screens, increasing hands-free capabilities on cell phones and automobiles to address the growing concern of distracted driving, and the adoption of our technology on a broadening scope of devices, such as televisions, set-top boxes, e-book readers and tablet computers. We are also seeing increased demand for transactions which involve the sale and delivery of both software and non-software related services or products, which may benefit from the application of ASC 605. We are investing to increase our capabilities and capacity to help device manufacturers build custom applications, to increase the capacity of our data centers, to increase the number, kinds and capacity of network services, to enable developers to access our technology, and to expand both awareness and channels for our direct-to-consumer products.

Enterprise. Sales in our enterprise market include on-demand solutions hosted by Nuance and priced by the volume of services used by the customer, as well as professional services to design, implement and integrate custom call center applications. Our objective for enterprise is to increase revenue, primarily by enabling customers to automate call center operations and call handling, and also to provide improved ability to analyze and use call center data, to enable mobile access, and to improve cross-channel coordination among call center, Internet and mobile customer-care functions. The call center market is migrating away from simple menu-driven applications toward more sophisticated, easier to use applications based on natural language capabilities. Our solutions address both menu-driven and natural language applications. In addition, we provide solutions for areas such as mobile access to customer care systems and call center analytics. Trends in our enterprise business include increasing interest in the use of mobile applications to access customer care systems and records, increasing interest in coordinating actions and data across customer care channels, and the ability of a broader set of hardware providers and systems integrators to serve the market. We are investing to expand our product set to address these opportunities, to increase efficiency of our hosted applications, expand our capabilities and capacity to help customers build custom applications, and broaden our relationships with new hardware and systems integrator partners serving the market.

Imaging. Sales in our imaging market include document capture and print management solutions embedded in copiers and multi-function printers and packaged software for document management. The imaging market is evolving to include more networked solutions, mobile access to networked solutions, and multi-function devices. We are investing to improve mobile access to our networked products, expand our distribution channels and embedding relationships, and expand our language coverage.

Acquisitions

We have supplemented organic growth with acquisitions. Over the last few years, our acquisitions have focused on adding new solutions that take advantage of our core technology, adding functionality to our existing solutions, expanding our sales and professional services teams, and expanding our customer base. We expect that new uses for our core technologies will continue to emerge and that international opportunities will grow. We expect that we will continue to serve evolving market opportunities through a combination of organic growth, acquisitions and strategic partnerships.

We believe we can fund our future acquisitions with our internally available cash, cash equivalents and marketable securities, cash generated from operations, amounts available under our existing debt capacity, additional borrowings or from the issuance of additional securities. We estimate the financial impact of any potential acquisition with regard to earnings, operating margin and cash flow targets before deciding to move forward with an acquisition.

Key Metrics

In evaluating the financial condition and operating performance of our business, management focuses on revenue, net income, gross margins, operating margins and cash flow from operations. A summary of these key financial metrics for the nine months ended June 30, 2011, as compared to the nine months ended June 30, 2010, is as follows:

Total revenue increased by $142.5 million to $951.7 million;

Net income increased by $64.6 million to $43.3 million;

Gross margins decreased by 1.3 percentage points to 61.8%;

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Operating margins increased by 4.3 percentage points to 4.6%; and

Cash provided by operating activities increased by $74.8 million to $259.5 million.

In addition to the above key financial metrics, we also focus on certain non-financial performance indicators. A summary of these key non-financial performance indicators as of and for the period ended June 30, 2011, as compared to June 30, 2010, is as follows:

Annualized line run-rate in our on-demand healthcare solutions increased 12% to approximately 3.706 billion lines per year. The annualized line run-rate is determined using billed equivalent line counts in a given quarter, multiplied by four;

Enterprise professional services backlog hours increased 1% to 316,000 hours. 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;

Estimated 3-year value of on-demand contracts increased 21% to $1.3 billion. We determine this value by using our best estimate of all anticipated future revenue streams under signed on-demand contracts currently in place, whether or not they are guaranteed through a minimum commitment clause. Our best estimate is based on assumptions about launch dates, volumes and renewal rates within the three year period. Most of these contracts are priced by volume of usage and typically have no or low minimum commitments. Actual revenue could vary from our estimates due to factors such as cancellations, non-renewals or volume fluctuations.

RESULTS OF OPERATIONS

TOTAL REVENUES

The following tables show total revenue from our four core markets 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
	2011	2010	Change	Change	2011	2010	Change	Change
Healthcare	$ 135.4	$ 113.5	$ 21.9	19.3%	$ 373.5	$ 324.9	$ 48.6	15.0%
Mobile and Consumer	91.6	66.3	25.3	38.2%	270.9	208.2	62.7	30.1%
Enterprise	68.5	71.0	(2.5)	(3.5)%	211.9	217.3	(5.4)	(2.5)%
Imaging	33.4	22.4	11.0	49.1%	95.4	58.8	36.6	62.2%
Total Revenues	$ 328.9	$ 273.2	$ 55.7	20.4%	$ 951.7	$ 809.2	$ 142.5	17.6%
United States	$ 237.4	$ 202.1	$ 35.3	17.5%	$ 701.4	$ 576.1	$ 125.3	21.7%
International	91.5	71.1	20.4	28.7%	250.3	233.1	17.2	7.4%

Total Revenues	$ 328.9	$ 273.2	$ 55.7	20.4%	$ 951.7	$ 809.2	$ 142.5	17.6%

For the three months ended June 30, 2011, revenues increased in Healthcare, Mobile and Consumer and Imaging as compared to the three months ended June 30, 2010. These increases in revenue were partially offset by a slight decrease in Enterprise revenue. Mobile and Consumer revenue increased primarily as a result of $19.5 million of additional product and licensing revenues as well as a $5.6 million increase in professional services and hosting revenues. The increase in Healthcare revenues was primarily driven by an increase of $11.3 million in product and licensing revenue and $8.0 million in professional services and hosting revenue. The Imaging revenue increase was attributable to growth in product and licensing revenues.

For the nine months ended June 30, 2011, revenue increased in Healthcare, Mobile and Consumer and Imaging as compared to the nine months ended June 30, 2010. These increases in revenue were partially offset by a slight decrease in Enterprise revenues. Mobile and Consumer revenues increased $62.7 million, with a $37.1 million

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increase in product and license revenues as well as a $24.4 million increase in professional services and hosting revenues. Healthcare revenues increased $48.6 million driven by a $29.1 million increase in professional services and hosting revenues and a $14.1 million increase in product and licensing revenue. Enterprise revenues decreased slightly, consisting of a $15.2 million decrease in professional services and hosting revenue, offset by an increase of $7.4 million in product and licensing revenues. The Imaging revenue increase was attributable to growth in product and licensing revenues.

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 June 30,		Dollar	Percent	Nine Months Ended June 30,		Dollar	Percent
	2011	2010	Change	Change	2011	2010	Change	Change
Product and licensing revenue	$ 152.7	$ 108.8	$ 43.9	40.3%	$ 428.2	$ 335.2	$ 93.0	27.7%
As a percentage of total revenue	46.5%	39.8%			45.0%	41.4%		

The increase in product and licensing revenue for the three months ended June 30, 2011, as compared to the three months ended June 30, 2010, included a $19.5 million increase in Mobile & Consumer product and licensing revenue, primarily driven by growth in sales of Mobile embedded solutions and our Dragon products. Healthcare product and licensing revenue increased $11.3 million resulting from strong bookings during the quarter. Imaging product and licensing revenue increased $10.7 million primarily driven by growth in sales of multi-functional peripheral licenses. Enterprise on premise license sales increased $2.4 million resulting from the refocusing of our sales efforts from channel to direct sales.

The increase in product and licensing revenue for the nine months ended June 30, 2011, as compared to the nine months ended June 30, 2010, consisted of a $37.2 million increase in Mobile and Consumer product and licensing revenues, which was primarily driven by growth in sales of our Dragon products. Imaging product and licensing revenue increased $34.3 million, primarily from sales of multi-functional peripheral products. Healthcare product and licensing revenue increased $14.1 million. Enterprise on premise license sales increased $7.4 million resulting from the refocusing of our sales efforts from channel to direct sales.

Professional Services and Hosting Revenue

Professional services revenue primarily consists of consulting, implementation and training services for customers. Hosting revenue primarily relates to delivering hosted services, such as medical transcription, automated customer care applications, voice message transcription, and mobile search and transcription, over a specified term. 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, 2011	Three Months Ended June 30, 2010	Dollar Change	Percent Change	Nine Months Ended June 30, 2011	Nine Months Ended June 30, 2010	Dollar Change	Percent Change
Professional services and hosting revenue	$ 125.4	$ 117.9	$ 7.5	6.4%	$ 377.1	$ 337.8	$ 39.3	11.6%
As a percentage of total revenue	38.1%	43.2%			39.6%	41.8%		

The increase in professional services and hosting revenue for the three months ended June 30, 2011, as compared to the three months ended June 30, 2010, included an $8.1 million increase in Healthcare revenue driven by growth in our on-demand solutions. Mobile and Consumer revenue increased $5.6 million primarily as a result of growth in our connected mobile services of $3.8 million and $1.8 million in professional services for our embedded solutions. Enterprise revenue decreased by $6.4 million, primarily due to the decline of an early, on-demand customer s volume.

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The increase in professional services and hosting revenue for the nine months ended June 30, 2011, as compared to the nine months ended June 30, 2010, consisted of a $29.1 million increase in Healthcare revenue primarily driven by growth in our on-demand solutions. Mobile and Consumer revenue increased $24.4 million primarily driven by $14.7 million of growth in our connected mobile services and $9.6 million of growth in professional services for our embedded solutions. Enterprise revenue decreased by $15.2 million, primarily as a result of the decline of an early, on-demand customer s volume.

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, 2011	Three Months Ended June 30, 2010	Dollar Change	Percent Change	Nine Months Ended June 30, 2011	Nine Months Ended June 30, 2010	Dollar Change	Percent Change
Maintenance and support revenue	$ 50.8	$ 46.5	$ 4.3	9.2%	$ 146.4	$ 136.2	$ 10.2	7.5%
As a percentage of total revenue	15.4%	17.0%			15.4%	16.8%		

The increase in maintenance and support revenue for the three months ended June 30, 2011, as compared to the three months ended June 30, 2010, is consistent with the growth in product and licensing sales. The increase included a $2.5 million increase in Healthcare and a $1.5 million increase in Enterprise.

The increase in maintenance and support revenue for the nine months ended June 30, 2011, as compared to the nine months ended June 30, 2010, is consistent with the growth in product and licensing sales. The increase included a $5.4 million increase in Healthcare and a $2.4 increase million in Enterprise.

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, 2011	Three Months Ended June 30, 2010	Dollar Change	Percent Change	Nine Months Ended June 30, 2011	Nine Months Ended June 30, 2010	Dollar Change	Percent Change
Cost of product and licensing revenue	$ 15.8	$ 10.9	$ 4.9	45.0%	$ 47.9	$ 34.2	$ 13.7	40.1%

As a percentage of product and licensing revenue	10.3%	10.0%	11.2%	10.2%

The increase in cost of product and licensing revenue for the three months ended June 30, 2011, as compared to the same period in 2010, was primarily due to an increase in hardware cost associated with higher product and license revenues. Gross margin remained relatively flat during the period.

The increase in cost of product and licensing revenue for the nine months ended June 30, 2011, as compared to same period in 2010, was primarily due to an increase in hardware cost associated with higher product and licensing revenues. Gross margin decreased one percentage point due to growth in Imaging product sales.

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 hosting 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):

	Three Months Ended June 30,		Dollar	Percent	Nine Months Ended June 30,		Dollar	Percent
	2011	2010	Change	Change	2011	2010	Change	Change
Cost of professional services and hosting revenue	$ 83.3	$ 71.4	$ 11.9	16.7%	$ 248.0	$ 206.3	$ 41.7	20.2%
As a percentage of professional services and hosting revenue	66.5%	60.6%			65.8%	61.1%		

The increase in cost of professional services and hosting revenue for the three months ended June 30, 2011, as compared to the three months ended June 30, 2010, was primarily attributable to a $4.6 million increase in transcription services related to our healthcare information management solutions, a $3.2 million increase in stock-based compensation and a $2.3 million increase in Enterprise costs driven by investment in professional service team and infrastructure which is intended to lead to future revenue contribution. The increase in stock-based compensation expense reduced gross margin by 2.4% during the period.

The increase in cost of professional services and hosting revenue for the nine months ended June 30, 2011, as compared to the nine months ended June 30, 2010, was primarily attributable to a $13.8 million increase in transcription services related to our healthcare information management solutions, a $12.3 million increase in stock-based compensation and a $7.7 million increase in Enterprise costs driven by investment in our professional service team and infrastructure which is intended to lead to future revenue contribution. The increase in stock-based compensation expense decreased gross margins by 3.0% during the period.

Cost of Maintenance and Support Revenue

Cost of maintenance and support revenue primarily consists of compensation for product support personnel and overhead. The following table shows cost of maintenance and support revenue, in dollars and as a percentage of maintenance and support revenue (dollars in millions):

	Three Months Ended June 30,		Dollar	Percent	Nine Months Ended June 30,		Dollar	Percent
	2011	2010	Change	Change	2011	2010	Change	Change
Cost of maintenance and support revenue	$ 8.8	$ 7.6	$ 1.2	15.8%	$ 26.6	$ 23.3	$ 3.3	14.2%
As a percentage of maintenance and support	17.3%	16.4%			18.2%	17.1%		

revenue

The increase in cost of maintenance and support revenue for the three and nine months ended June 30, 2011, as compared to the same periods in 2010, was primarily due to higher volumes of Enterprise application maintenance and support.

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Research and Development Expense

Research and development expense primarily consists of salaries, benefits and overhead relating to engineering staff. The following table shows research and development expense, 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
	2011	2010	Change	Change	2011	2010	Change	Change
Total research and development expense	$ 42.2	$ 38.9	$ 3.3	8.5%	$ 129.9	$ 113.8	$ 16.1	14.1%
As a percentage of total revenue	12.8%	14.2%			13.6%	14.1%		

The increase in research and development expense for the three months ended June 30, 2011, as compared to the three months ended June 30, 2010, was primarily attributable to an increase of $6.0 million in compensation expense including a $3.0 million increase in stock-based compensation expense. The increase in expenses was offset by reimbursement of $4.6 million under a new collaboration agreement signed during the period.

The increase in research and development expense for the nine months ended June 30, 2011, as compared to the nine months ended June 30, 2010, was attributable to increase in compensation expense including an $11.5 million increase in stock-based compensation, driven by headcount growth and investment in the research and development organization. This increase in expense was offset by reimbursement of $4.6 million under a new collaboration agreement signed during the period.

Sales and Marketing Expense

Sales and marketing expense includes salaries and benefits, commissions, advertising, direct mail, public relations, tradeshow costs and other costs of marketing programs, travel expenses associated with our sales organization and overhead. The following table shows sales and marketing expense, 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
	2011	2010	Change	Change	2011	2010	Change	Change
Total sales and marketing expense	$ 73.3	$ 67.2	$ 6.1	9.1%	$ 225.8	$ 196.7	$ 29.1	14.8%
As a percentage of total revenue	22.3%	24.6%			23.7%	24.3%		

The increase in sales and marketing expense for the three months ended June 30, 2011, as compared to the three months ended June 30, 2010, was primarily attributable to a $3.4 million increase in compensation expense as well as a $2.0 million increase in marketing and channel program spending intended to drive overall revenue growth.

The increase in sales and marketing expense for the nine months ended June 30, 2011, as compared to the nine months ended June 30, 2010, was primarily attributable to a $14.6 million increase in marketing and channel program spending to drive overall revenue growth, as well as an $11.8 million increase in compensation expense. The increase in compensation expense was attributable to additional headcount as well as an increase of $2.9 million in stock-based compensation.

General and Administrative Expense

General and administrative expense primarily consists of personnel costs for administration, finance, human resources, information systems, facilities and general management, fees for external professional advisors

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including accountants and attorneys, insurance, and provisions for doubtful accounts. The following table shows general and administrative expense, in dollars and as a percentage of total revenue (dollars in millions):

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Dollar Change	Percent Change	Nine Months Ended June 30, 2011	Nine Months Ended June 30, 2010	Dollar Change	Percent Change
Total general and administrative expense	$ 35.9	$ 29.9	$ 6.0	20.1%	$ 104.3	$ 88.6	$ 15.7	17.7%
As a percentage of total revenue	10.9%	10.9%			11.0%	11.0%		

The increase in general and administrative expense for the three months ended June 30, 2011, as compared to the three months ended June 30, 2010, was primarily attributable to a $3.7 million increase in compensation expense including a $1.4 million increase in stock-based compensation and a $3.1 million increase in legal and professional expenses.

The increase in general and administrative expense for the nine months ended June 30, 2011, as compared to the nine months ended June 30, 2010, was primarily attributable to a $12.0 million increase in compensation expense, including an $8.9 million increase in stock-based compensation and a $3.5 million increase in legal and professional expenses

Amortization of Intangible Assets

Amortization of acquired patents and core and completed technology are included in cost of revenue and the amortization of acquired customer and contractual relationships, non-compete agreements, acquired tradenames and trademarks, and other intangibles are included in operating expenses. Customer relationships are amortized on an accelerated basis based upon the pattern in which the economic benefits of the customer relationships are being realized. Other identifiable intangible assets are amortized on a straight-line basis over their estimated useful lives. Amortization expense was recorded as follows (dollars in millions):

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Dollar Change	Percent Change	Nine Months Ended June 30, 2011	Nine Months Ended June 30, 2010	Dollar Change	Percent Change
Cost of revenue	$ 13.1	$ 11.9	$ 1.2	10.1%	$ 40.5	$ 35.1	$ 5.4	15.4%
Operating expenses	21.0	21.5	(0.5)	(2.3)%	65.2	65.8	(0.6)	(0.9)%
Total amortization expense	$ 34.1	$ 33.4	$ 0.7	2.1%	$ 105.7	$ 100.9	$ 4.8	4.8%
As a percentage of total revenue	10.4%	12.2%			11.1%	12.5%		

The increase in amortization of intangible assets for the three and nine months ended June 30, 2011, as compared to the same periods in 2010, was primarily attributable to the amortization of acquired intangible assets from our business acquisitions during fiscal 2010 and 2011 and our acquisitions of patents and technology from other third-parties during fiscal 2010. This increase was partially offset by a reduction in amortization of customer relationships that are recognized over the period of the expected economic benefit.

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. Acquisition-related costs were recorded as follows (dollars in millions):

	Three Months Ended June 30, 2011	2010	Dollar Change	Percent Change	Nine Months Ended June 30, 2011	2010	Dollar Change	Percent Change
Transition and integration costs	$ 0.4	$ 3.4	$ (3.0)	(88.2)%	$ 1.5	$ 12.1	$ (10.6)	(87.6)%
Professional service fees	7.8	3.1	4.7	151.6%	11.1	14.9	(3.8)	(25.5)%
Acquisition-related adjustments	0.4	(0.4)	0.8	200.0%	1.3	(0.1)	1.4	1,400.0%
Total Acquisition-related costs, net	$ 8.6	$ 6.1	$ 2.5	41.0%	$ 13.9	$ 26.9	$ (13.0)	(48.3)%
As a percentage of total revenue	2.6%	2.2%			1.5%	3.3%		

The increase in acquisition-related costs, net for the three months ended June 30, 2011, as compared to the three months ended June 30, 2010, was primarily driven by a reduction in transition and integration costs offset by an increase in professional service fees. For the three months ended June 30, 2010, transition and integration costs consisted primarily of costs associated with transitional employees from our acquisitions of SpinVox and eCopy. For the three months ended June 30, 2011, professional service fees consisted of expenses related to our third quarter 2011 acquisitions.

The decrease for the nine months ended June 30, 2011, as compared to the nine months ended June 30, 2010, was primarily driven by a reduction in transition and integration costs and professional services fees. For the nine months ended June 30, 2010, transition and integration costs consisted primarily of the costs associated with transitional employees from our acquisitions of SpinVox and eCopy; professional services consisted of expenses related to our acquisition of SpinVox in December 2009 and approximately $2.2 million that had been capitalized as of September 30, 2009 related to transaction costs incurred in prior periods that was required to be expensed upon our adoption of ASC 805, *Business Combinations*, in fiscal 2010.

Restructuring and Other Charges, Net

The following table sets forth the activity relating to the restructuring accruals for the nine months ended June 30, 2011 (dollars in millions):

	Personnel	Facilities	Other	Total
Balance at September 30, 2010	$ 1.8	$ 0.3	$	$ 2.1
Restructuring and other charges	3.9	1.5	0.3	5.7
Non-cash adjustments	0.2		(0.2)	
Cash payments	(4.6)	(0.9)	(0.1)	(5.6)
Balance at June 30, 2011	$ 1.3	$ 0.9	$	$ 2.2

For the nine months ended June 30, 2011, we recorded net restructuring and other charges of $5.6 million, which included $3.9 million of severance and other costs related to the elimination of approximately 90 personnel across multiple functions worldwide, primarily within costs of sales, and $1.5 million related to facilities that we no longer occupy.

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Other Income (Expense), Net

The following table shows other income (expense), net in dollars and as a percentage of total revenue (dollars in millions):

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Dollar Change	Percent Change	Nine Months Ended June 30, 2011	Nine Months Ended June 30, 2010	Dollar Change	Percent Change
Interest income	$ 0.7	$ 0.2	$ 0.5	250.0%	$ 2.2	$ 0.8	$ 1.4	175.0%
Interest expense	(8.7)	(10.0)	1.3	13.0%	(26.8)	(30.4)	3.6	11.8%
Other income (expense), net	0.3	5.5	(5.2)	(94.5)%	8.9	10.7	(1.8)	(16.8)%
Total other income (expense), net	$ (7.7)	$ (4.3)	$ (3.4)	79.1%	$ (15.7)	$ (18.9)	$ 3.2	16.9%
As a percentage of total revenue	(2.3)%	(1.6)%			(1.7)%	(2.3)%		

The decrease in interest expense for the three and nine months ended June 30, 2011 as compared to the same period in 2010, was driven by decreased interest costs as a result of lower rates on our outstanding variable rate borrowings. Included in other income (expense), net for the three and nine months ended June 30, 2011, are gains of $0.4 million and $10.8 million, respectively, on our security price guarantee derivatives.

Provision for Income Taxes

The following table shows the provision for income taxes and the effective income tax rate (dollars in millions):

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Dollar Change	Percent Change	Nine Months Ended June 30, 2011	Nine Months Ended June 30, 2010	Dollar Change	Percent Change
Income (loss) before income taxes	$ 18.2	$ 0.3	$ 17.9	5,966.7%	$ 28.4	$ (16.7)	$ 45.1	270.1%
Income tax (benefit) provision	$ (23.4)	$ 1.8	$ (25.2)	(1,400.0)%	$ (15.0)	$ 4.5	$ (19.5)	(433.3)%
	(128.3)%	608.3%			(52.8)%	(26.6)%		

Effective
income tax
rate

The change in the effective tax rate and the decrease in the income tax provision, was primarily related to a one-time tax benefit recorded in connection with the Equitrac acquisition for which a net deferred tax liability was recorded in purchase accounting releasing the valuation reserve, resulting in the recognition of a tax benefit for the three and nine months ended June 30, 2011. This tax benefit was offset by the tax provision on U.S. profits in the three and nine months ended June 30, 2011.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents totaled $447.0 million as of June 30, 2011, a decrease of $69.6 million as compared to $516.6 million as of September 30, 2010. Our working capital was $354.1 million as of June 30, 2011, as compared to $459.2 million as of September 30, 2010. Cash and marketable securities held by our international operations totaled $89.3 million and $40.5 million at June 30, 2011 and September 30, 2010, respectively. We expect the cash held overseas will continue to be used for our international operations and therefore do not anticipate repatriating these funds. If we were to repatriate these funds, we do not believe that the amount of withholding taxes payable as a result would have a material impact to our liquidity. As of June 30, 2011, our total accumulated deficit was $238.0 million. We do not expect our accumulated deficit to impact our future ability to operate the business given our strong cash and operating cash flow positions, and believe our current cash and cash equivalents and marketable securities on-hand are sufficient to meet our operating needs for at least the next twelve months.

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Cash Provided by Operating Activities

Cash provided by operating activities for the nine months ended June 30, 2011 was $259.5 million, an increase of $74.8 million, or 40.5%, as compared to cash provided by operating activities of $184.7 million for the nine months ended June 30, 2010. The increase was primarily driven by the following factors:

- An increase of $72.3 million in cash flows resulting from an increase in net income, exclusive of non-cash adjustment items which include a one-time non-cash tax benefit adjustment of $34.7 million reducing the valuation allowance on deferred tax assets as a result of the Equitrac acquisition;

- An increase in cash flows of $13.6 million from an overall increase in deferred revenue; and

- A decrease of $11.0 million in cash flows generated by changes in working capital excluding deferred revenue, primarily driven by a 18.0 million ($23.4 million equivalent) payment in fiscal 2011 for a fixed obligation assumed in connection with our acquisition of SpinVox, offset by an increase of $9.3 million due to changes in accounts receivable.

Cash Used in Investing Activities

Cash used in investing activities for the nine months ended June 30, 2011 was $331.2 million, an increase of $107.1 million, or 47.8%, as compared to cash used in investing activities of $224.1 million for the nine months ended June 30, 2010. The net increase was primarily driven by the following factors:

- Cash outflows of $319.3 million as a result of our third quarter fiscal 2011 acquisitions. During the nine months ended June 30, 2010 cash outflows for acquisitions were $155.9 million, primarily related to the acquisition of SpinVox and the PSRS deferred acquisition payments.

- A cash inflow of $17.2 million in restricted cash in December 2010 related to the release of cash placed in an irrevocable standby letter of credit account for payment of a fixed obligation in connection with our acquisition of SpinVox; and

- A use of $15.0 million for a cash payment to acquire an equity investment in a non-public company during the six months ended March 31, 2010.

Cash Used in/Provided by Financing Activities

Cash used in financing activities for the nine months ended June 30, 2011 was $4.3 million as compared to cash provided by financing activities of $9.8 million for the nine months ended June 30, 2010, a decrease in cash flows of $14.2 million or 144.1%. The change was primarily driven by the following factors:

- An increase in cash used to net share settle employee equity awards of $12.0 million, due to an increase in intrinsic value of the shares vested as a result of the overall increase in our stock price and vesting activities during the nine months ended June 30, 2011 as compared to the same period in 2010; and

- A decrease of $12.4 million in proceeds from the issuance of common stock relating to the warrant that was exercised during the nine months ended June 30, 2010; offset by

- An $8.2 million cash benefit resulting from excess tax benefits on employee equity awards during the nine months ended June 30, 2011.

Credit Facilities and Debt

2.75% Convertible Debentures

We have $250 million of 2.75% convertible senior debentures due in August 2027. As of June 30, 2011, 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.

Credit Facility

As of June 30, 2011, $638.5 million remained outstanding under our term loan. There were $15.7 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, 2011, we are in compliance with the covenants under the Credit Facility.

As of June 30, 2011, based on our leverage ratio, the applicable margin for our term loan was 0.75% for base rate borrowings and 1.75% for LIBOR-based borrowings. This results in an effective interest rate of 1.95%. No payments under the excess cash flow sweep provision were due in the first quarter of fiscal 2011 as no excess cash flow, as defined, was generated in fiscal 2010. 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.

In July 2011, we entered in to agreements to amend and restate our existing Credit Facility. Of the approximately $638.5 million remaining Term Loan originally due March 31, 2013, lenders representing $486.9 million have elected to extend the maturity date three years to March 31, 2016. The remaining $151.6 million in term loans are due March 2013. In addition, lenders participating in the revolving credit facility have chosen to extend the maturity date by three years to March 31, 2015.

In conjunction with the amendment, the Credit Facility repayment terms were amended. Principal is due in four quarterly installments of 1% per annum through the original maturity date of March 2013, at which time the principal remaining on the unextended portion of the loans becomes payable. The table below details the new schedule of principal payments by fiscal year. If only the minimum required repayments are made, the annual aggregate principal amount of the term loans repaid would be as follows (dollars in thousands):

Year Ending September 30,	**Amount**
2011 (quarter ending September 30)	$ 1,596
2012	6,346
2013	154,494
2014	4,743
2015	4,696
2016	466,663
Total	$ 638,538

Under terms of the amendment, borrowings under the Credit Facility bear interest at a rate equal to the applicable margin plus, at our option, either (a) the base rate which is the higher of the corporate base rate of UBS AG, Stamford Branch, or the federal funds rate plus 0.50% per annum or (b) LIBOR (equal to (i) the British Bankers Association Interest Settlement Rates for deposits in U.S. dollars divided by (ii) one minus the statutory reserves applicable to such borrowing). The applicable margin for the borrowings is as follows:

Description	**Base Rate Margin**	**LIBOR Margin**
Term loans due March 2013	0.75% - 1.50%(a)	1.75% - 2.50%(a)
Term loans due March 2016	2.00%	3.00%

Revolving facility due March 2015	1.25% - 2.25%(b)	2.25% - 3.25%(b)

(a) The margin is determined based on our leverage ratio at the date the interest rates are reset on the Term Loans.

(b) The margin is determined based on our credit rating at the date the interest rates are reset on the Revolving Loans

We believe that cash flows from future operations in addition to cash and cash equivalents and marketable securities on-hand will be sufficient to meet our working capital, investing, financing and contractual obligations and the contingent payments for acquisitions, if any are realized, as they become due for at least the next twelve months. We also believe that in the event future operating results are not as planned, that we could take actions, including restructuring actions and other cost reduction initiatives, to reduce operating expenses to levels which, in combination with expected future revenue, will continue to generate sufficient operating cash flow. In the event that these actions are not effective in generating operating cash flows we may be required to issue equity or debt securities on terms that may be less favorable.

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Off-Balance Sheet Arrangements, Contractual Obligations

Contractual Obligations

The following table outlines our contractual payment obligations as of June 30, 2011 (dollars in millions):

	Payments Due by Period					
Contractual Obligations	Total	Remaining Fiscal 2011	Fiscal 2012	Fiscal 2013 and 2014	Fiscal 2015 and 2016	Thereafter
2.75% Convertible Senior Debentures(1)	$ 250.0	$	$	$ 250.0	$	$
Credit Facility(2)	638.5	1.6	6.3	159.2	471.4	
Interest on Credit Facility(2)	77.7	4.6	18.6	32.0	22.5	
Interest on 2.75% Convertible Senior Debentures(3)	24.1	3.4	6.9	13.8		
Letter of credit(4)	7.2	7.2				
Lease obligations and other liabilities:						
Operating leases	128.7	6.1	24.4	40.8	32.7	24.7
Other lease obligations associated with the closing of duplicate facilities related to restructurings and acquisitions	3.2	0.9	1.8	0.5		
Pension, minimum funding requirement(5)	4.5	0.3	1.4	2.8		
Collaboration agreements(6)	72.7	18.4	23.4	28.4	2.5	
Other liabilities assumed(7)	24.6	3.6	12.5	5.0	3.5	
Total contractual cash obligations	$ 1,231.2	$ 46.1	$ 95.3	$ 532.5	$ 532.6	$ 24.7

(1) Holders of the 2.75% Senior Convertible Debentures have the right to require us to repurchase the debentures on August 15, 2014, 2017 and 2022.

(2) Interest is due and payable monthly under the Credit Facility, and principal is paid on a quarterly basis. The amounts included as interest payable in this table are based on the effective interest rate related to the July 2011 amended Credit Facility.

(3) Interest is due and payable semi-annually under the 2.75% convertible senior debentures.

(4) We have placed EUR 5.0 million ($7.2 million based on the June 30, 2011 exchange rates) in an irrevocable standby letter of credit account for payment of a fixed obligation assumed in connection with our acquisition of SpinVox.

(5)

Our U.K. pension plan has a minimum funding requirement of £859,900 ($1.4 million based on the exchange rate at June 30, 2011) for each of the next 4 years, through fiscal 2014.

(6) Payments under the research collaboration agreements are payable in cash or common stock at our option.

(7) Obligations include assumed long-term liabilities related to restructuring programs initiated by the predecessor entities prior to our acquisition of SpeechWorks International, Inc. in August 2003, and our acquisition of the former Nuance Communications, Inc. in September 2005. These restructuring programs relate to the closing of two facilities with lease terms set to expire in 2016 and 2012. Total contractual obligations under these two leases are $24.6 million. As of June 30, 2011, we have sub-leased a portion of the office space related to these two facilities to unrelated third parties. Total sublease income under the remaining contractual terms is expected to be $9.1 million, which ranges from $1.5 million to $4.1 million on an annualized basis through 2016.

The gross liability for unrecognized tax benefits as of June 30, 2011 and September 30, 2010 was$13.4 million and $12.8 million, respectively. We do not expect a significant change in the amount of unrecognized tax benefits within the next 12 months. We estimate that none of this amount will be paid within the next year and we are currently unable to reasonably estimate the timing of payments for the remainder of the liability.

Contingent Liabilities and Commitments

In connection with certain of our acquisitions, we have agreed to make contingent cash payments to the former shareholders of certain of the acquired companies. The following represents the contingent cash payments that we may be required to make.

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 we 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 short-term liabilities as of June 30, 2011.

In connection with our acquisition of Vocada, Inc. (Vocada) in November 2007, we agreed to make contingent earn-out payments of up to $21.0 million upon the achievement of certain financial targets measured over defined periods through December 31, 2010, in accordance with the merger agreement. We have notified the former shareholders of Vocada that the financial targets were not achieved. In December 2010, the former shareholders filed a demand for arbitration in accordance with their rights under the merger agreement. At June 30, 2011, we have not recorded any obligation relative to these earn-out provisions.

Off-Balance Sheet Arrangements

Through June 30, 2011, we have not entered into any off-balance sheet arrangements or material transactions with unconsolidated entities or other persons.

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, 2010. 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 the adoption of new revenue accounting standards, 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.

Item 3. *Quantitative and Qualitative Disclosures about Market Risk*

We are exposed to market risk from changes in foreign currency exchange rates, interest rates and equity prices which could affect operating results, financial position and cash flows. We manage our exposure to these market risks through our regular operating and financing activities and, when appropriate, through the use of derivative financial instruments.

Exchange Rate Sensitivity

We are exposed to changes in foreign currency exchange rates. Any foreign currency transaction, defined as a transaction denominated in a currency other than the U.S. dollar, will be reported in U.S. dollars at the applicable exchange rate. Assets and liabilities are translated into U.S. dollars at exchange rates in effect at the balance sheet date and income and expense items are translated at average rates for the period. The primary foreign currency denominated transactions include revenue and expenses and the resulting accounts receivable and accounts payable balances reflected on our balance sheet. Therefore, the change in the value of the U.S. dollar compared to foreign currencies will have either a positive or negative effect on our financial position and results of operations. Historically, our primary exposure has related to transactions denominated in the euro, British Pound, Canadian Dollar, Japanese Yen, Indian Rupee and Hungarian Forint.

A hypothetical change of 10% in appreciation or depreciation in foreign currency exchange rates from the quoted foreign currency exchange rates at June 30, 2011 would not have a material impact on our revenue, operating results or cash flows in the coming year.

Periodically, we enter into forward exchange contracts to hedge against foreign currency fluctuations. These contracts may or may not be designated as cash flow hedges for accounting purposes. At June 30, 2011, we have foreign currency contracts with a total notional value of approximately $2.2 million designated as cash flow hedges. These contracts all mature within the next twelve months. During the nine months ended June 30, 2011, we commenced a program that primarily utilizes forward currency contracts to offset the risks associated with foreign currency denominated assets and liabilities. We established this program so that gains and losses from remeasurement or settlement of these assets and liabilities are offset by gain or losses on the foreign currency forward contracts thus mitigating the risks and volatility associated with our foreign currency transactions. These contracts are not designated as accounting hedges and generally are for periods of 30 days or less. The notional contract amount of outstanding foreign currency exchange contracts not designated as cash flow hedges was $165.4 million at June 30, 2011. Based on the nature of the transaction for which the contracts were purchased, a hypothetical change of 10% in exchange rates would not have a material impact on our financial results.

Interest Rate Sensitivity

We are exposed to interest rate risk as a result of our significant cash and cash equivalents, and the outstanding debt under the Credit Facility.

At June 30, 2011, we held approximately $447.0 million of cash and cash equivalents primarily consisting of cash, time deposits and money-market funds. Due to the low current market yields and the short-term nature of our investments, a hypothetical change in market rates of one percentage point would not have a material effect on the fair value of our portfolio or results of operations.

At June 30, 2011, our total outstanding debt balance exposed to variable interest rates was $638.5 million. A hypothetical change in market rates could have a significant impact on interest expense and amounts payable. Assuming a one percentage point increase in interest rates, our interest expense relative to our outstanding debt would increase $6.4 million per annum.

Equity Price Risk

We are exposed to equity price risk as a result of security price guarantees that we enter in to from time to time. Generally, these price guarantees are for a period of six months or less, and require payment from either us to a third party, or from the third party to us, based upon changes in our stock price during the contract term. As of June 30, 2011, we had security price guarantees on approximately 250,000 of our shares with prices between $19.55 and $20.28. A change of 10% in our stock price during the next six months would not have a material effect on our results of operations or our cash flows.

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Item 4. *Controls and Procedures*

Evaluation of Disclosure Controls and Procedures

Our management is responsible for establishing and maintaining a system of disclosure controls and procedures (as defined in Rule 13a-15 under the Securities Exchange Act of 1934 (the Exchange Act)) designed to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer s management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

We have evaluated the effectiveness of the design and operation of our disclosure controls and procedures under the supervision of, and with the participation of, management, including our Chief Executive Officer and Chief Financial Officer, as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective to meet the requirements of Rule 13a-15 under the Exchange Act.

Changes in internal control over financial reporting

There were no changes to our internal controls over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during the fiscal quarter covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II. Other Information

Item 1. *Legal Proceedings*

This information is included in Note 18, Commitments and Contingencies, in the accompanying notes to consolidated financial statements and is incorporated herein by reference from Item 1 of Part I.

Item 1A. *Risk Factors*

You should carefully consider the risks described below when evaluating our company and when deciding whether to invest in our company. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we do not currently believe are important to an investor may also harm our business operations. If any of the events, contingencies, circumstances or conditions described in the following risks actually occurs, our business, financial condition or our results of operations could be seriously harmed. If that happens, the trading price of our common stock could decline and you may lose part or all of the value of any of our shares held by you.

Risks Related to Our Business

Our operating results may fluctuate significantly from period to period, and this may cause our stock price to decline.

Our revenue and operating results have fluctuated in the past and are expected to continue to fluctuate in the future. Given this fluctuation, we believe that quarter to quarter comparisons of revenue and operating results are not necessarily meaningful or an accurate indicator of our future performance. As a result, our results of operations may not meet the expectations of securities analysts or investors in the future. If this occurs, the price of our stock would likely decline. Factors that contribute to fluctuations in operating results include the following:

- slowing sales by our distribution and fulfillment partners to their customers, which may place pressure on these partners to reduce purchases of our products;

volume, timing and fulfillment of customer orders;

our efforts to generate additional revenue from our intellectual property portfolio;

customers delaying their purchasing decisions in anticipation of new versions of our products;

customers delaying, canceling or limiting their purchases as a result of the threat or results of terrorism;

introduction of new products by us or our competitors;

seasonality in purchasing patterns of our customers;

reduction in the prices of our products in response to competition, market conditions or contractual obligations;

returns and allowance charges in excess of accrued amounts;

timing of significant marketing and sales promotions;

impairment charges against goodwill and intangible assets;

delayed realization of synergies resulting from our acquisitions;

write-offs of excess or obsolete inventory and accounts receivable that are not collectible;

increased expenditures incurred pursuing new product or market opportunities;

general economic trends as they affect retail and corporate sales; and

higher than anticipated costs related to fixed-price contracts with our customers.

Due to the foregoing factors, among others, our revenue and operating results are difficult to forecast. Our expense levels are based in significant part on our expectations of future revenue and we may not be able to reduce our expenses quickly to respond to a shortfall in projected revenue. Therefore, our failure to meet revenue expectations would seriously harm our operating results, financial condition and cash flows.

We have grown, and may continue to grow, through acquisitions, which could dilute our existing stockholders.

As part of our business strategy, we have in the past acquired, and expect to continue to acquire, other businesses and technologies. In connection with past acquisitions, we issued a substantial number of shares of our common stock as transaction consideration and also incurred significant debt to finance the cash consideration used for our acquisitions. We may continue to issue equity securities for future acquisitions, which would dilute existing stockholders, perhaps significantly depending on the terms of such acquisitions. We may also incur additional debt in connection with future acquisitions, which, if available at all, may place additional restrictions on our ability to operate our business.

Our ability to realize the anticipated benefits of our acquisitions will depend on successfully integrating the acquired businesses.

Our prior acquisitions required, and our recently completed acquisitions continue to require, substantial integration and management efforts and we expect future acquisitions to require similar efforts. Acquisitions of this nature involve a number of risks, including:

- difficulty in transitioning and integrating the operations and personnel of the acquired businesses;
- potential disruption of our ongoing business and distraction of management;
- potential difficulty in successfully implementing, upgrading and deploying in a timely and effective manner new operational information systems and upgrades of our finance, accounting and product distribution systems;
- difficulty in incorporating acquired technology and rights into our products and technology;
- potential difficulties in completing projects associated with in-process research and development;

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unanticipated expenses and delays in completing acquired development projects and technology integration;

management of geographically remote business units both in the United States and internationally;

impairment of relationships with partners and customers;

assumption of unknown material liabilities of acquired companies;

accurate projection of revenue plans of the acquired entity in the due diligence process;

customers delaying purchases of our products pending resolution of product integration between our existing and our newly acquired products;

entering markets or types of businesses in which we have limited experience; and

potential loss of key employees of the acquired business.

As a result of these and other risks, if we are unable to successfully integrate acquired businesses, we may not realize the anticipated benefits from our acquisitions. Any failure to achieve these benefits or failure to successfully integrate acquired businesses and technologies could seriously harm our business.

Accounting treatment of our acquisitions could decrease our net income or expected revenue in the foreseeable future, which could have a material and adverse effect on the market value of our common stock.

Under accounting principles generally accepted in the United States of America, we record the market value of our common stock or other form of consideration issued in connection with the acquisition and, for transactions which closed prior to October 1, 2009, the amount of direct transaction costs as the cost of acquiring the company or business. We have allocated that cost to the individual assets acquired and liabilities assumed, including various identifiable intangible assets such as acquired technology, acquired tradenames and acquired customer relationships based on their respective fair values. Intangible assets are generally amortized over a five to ten year period. Goodwill and certain intangible assets with indefinite lives, are not subject to amortization but are subject to an impairment analysis, at least annually, which may result in an impairment charge if the carrying value exceeds its implied fair value. As of June 30, 2011, we had identified intangible assets of approximately $757.6 million, net of accumulated amortization, and goodwill of approximately $2.3 billion. In addition, purchase accounting limits our ability to recognize certain revenue that otherwise would have been recognized by the acquired company as an independent business. As a result, the combined company may delay revenue recognition or recognize less revenue than we and the acquired company would have recognized as independent companies.

Our significant debt could adversely affect our financial health and prevent us from fulfilling our obligations under our credit facility and our convertible debentures.

We have a significant amount of debt. As of June 30, 2011, we had a total of $889.1 million of gross debt outstanding, including $151.6 million in term loans due in March 2013, $486.9 million in term loans due in March 2016 under an amended and restated agreement signed in July 2012, and $250.0 million in convertible debentures which investors may require us to redeem in August 2014. We also have a $75.0 million revolving credit line available to us through March 2015. As of June 30, 2011, there were $15.7 million of letters of credit issued under the revolving credit line but there were no other outstanding borrowings under the revolving credit line. Our debt level could have important consequences, for example it could:

require us to use a large portion of our cash flow to pay principal and interest on debt, including the convertible debentures and the credit facility, which will reduce the availability of our cash flow to fund working capital, capital expenditures, acquisitions, research and development expenditures and other business activities;

restrict us from making strategic acquisitions or exploiting business opportunities;

place us at a competitive disadvantage compared to our competitors that have less debt; and limit, along with the financial and other restrictive covenants related to our debt, our ability to borrow additional funds, dispose of assets or pay cash dividends.

Our ability to meet our payment and other obligations under our debt instruments depends on our ability to generate significant cash flow in the future. This, to some extent, is subject to general economic, financial, competitive, legislative and regulatory factors as well as other factors that are beyond our control. We cannot assure you that our business will generate cash flow from operations, or that additional capital will be available to us, in an amount sufficient to enable us to meet our payment obligations under the convertible debentures and our other debt and to fund other liquidity needs. If we are not able to generate sufficient cash flow to service our debt obligations, we may need to refinance or restructure our debt, including the convertible debentures, sell assets, reduce or delay capital investments, or seek to raise additional capital. If we are unable to implement one or more of these alternatives, we may not be able to meet our payment obligations under the convertible debentures and our other debt.

In addition, a substantial portion of our debt bears interest at variable rates. If market interest rates increase, our debt service requirements will increase, which would adversely affect our results of operations and cash flows.

Our debt agreements contain covenant restrictions that may limit our ability to operate our business.

The agreement governing our senior credit facility contains, and any of our other future debt agreements may contain, covenant restrictions that limit our ability to operate our business, including restrictions on our ability to:

- incur additional debt or issue guarantees;
- create liens;
- make certain investments;
- enter into transactions with our affiliates;
- sell certain assets;
- redeem capital stock or make other restricted payments;
- declare or pay dividends or make other distributions to stockholders; and
- merge or consolidate with any entity.

Our ability to comply with these covenants is dependent on our future performance, which will be subject to many factors, some of which are beyond our control, including prevailing economic conditions. As a result of these covenants, our ability to respond to changes in business and economic conditions and to obtain additional financing, if needed, may be significantly restricted, and we may be prevented from engaging in transactions that might otherwise be beneficial to us. In addition, our failure to comply with these covenants could result in a default under our debt agreements, which could permit the holders to accelerate our obligation to repay the debt. If any of our debt is accelerated, we may not have sufficient funds available to repay the accelerated debt.

We have a history of operating losses, and may incur losses in the future, which may require us to raise additional capital on unfavorable terms.

We reported net losses of $19.1 million, $19.4 million and $37.0 million for the fiscal years 2010, 2009 and 2008, respectively. If we are unable to achieve and maintain profitability, the market price for our stock may decline, perhaps substantially. We cannot assure you that our revenue will grow or that we will achieve or maintain profitability in the future. If we do not achieve and maintain profitability, we may be required to raise additional capital to maintain or grow our operations. Additional capital, if available at all, may be highly dilutive to existing investors or contain other unfavorable terms, such as a high interest rate and restrictive covenants.

Voice and language technologies may not achieve widespread acceptance, which could limit our ability to grow our voice and language business.

We have invested and expect to continue to invest heavily in the acquisition, development and marketing of voice and language technologies. The market for voice and language technologies is relatively new and rapidly

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evolving. Our ability to increase revenue in the future depends in large measure on the acceptance of these technologies in general and our products in particular. The continued development of the market for our current and future voice and language solutions will also depend on:

- consumer and business demand for speech-enabled applications;
- development by third-party vendors of applications using voice and language technologies; and
- continuous improvement in voice and language technology.

Sales of our voice and language products would be harmed if the market for these technologies does not continue to develop or develops slower than we expect, and, consequently, our business could be harmed and we may not recover the costs associated with our investment in these technologies.

The markets in which we operate are highly competitive and rapidly changing and we may be unable to compete successfully.

There are a number of companies that develop or may develop products that compete in our targeted markets. The individual markets in which we compete are highly competitive, and are rapidly changing. Within voice and language, we compete with AT&T, Microsoft, Google, and other smaller providers. Within healthcare, we compete with Medquist and other smaller providers. Within imaging, we compete with ABBYY, Adobe, I.R.I.S. and NewSoft. In voice and language, some of our partners such as Avaya, Cisco, Edify, Genesys and Nortel develop and market products that can be considered substitutes for our solutions. In addition, a number of smaller companies in voice, language and imaging produce technologies or products that are in some markets competitive with our solutions. Current and potential competitors have established, or may establish, cooperative relationships among themselves or with third parties to increase the ability of their technologies to address the needs of our prospective customers.

The competition in these markets could adversely affect our operating results by reducing the volume of the products we license or the prices we can charge. Some of our current or potential competitors, such as Adobe, Microsoft and Google, have significantly greater financial, technical and marketing resources than we do. These competitors may be able to respond more rapidly than we can to new or emerging technologies or changes in customer requirements. They may also devote greater resources to the development, promotion and sale of their products than we do.

Some of our customers, such as Microsoft and Google, have developed or acquired products or technologies that compete with our products and technologies. These customers may give higher priority to the sale of these competitive products or technologies. To the extent they do so, market acceptance and penetration of our products, and therefore our revenue, may be adversely affected. Our success will depend substantially upon our ability to enhance our products and technologies and to develop and introduce, on a timely and cost-effective basis, new products and features that meet changing customer requirements and incorporate technological enhancements. If we are unable to develop new products and enhance functionalities or technologies to adapt to these changes, or if we are unable to realize synergies among our acquired products and technologies, our business will suffer.

The failure to successfully maintain the adequacy of our system of internal control over financial reporting could have a material adverse impact on our ability to report our financial results in an accurate and timely manner.

The SEC, as directed by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules requiring public companies to include a report of management on internal control over financial reporting in their annual reports on Form 10-K that contains an assessment by management of the effectiveness of our internal control over financial reporting. In addition, our independent registered public accounting firm must attest to and report on the effectiveness of our internal control over financial reporting. Any failure in the effectiveness of our system of internal control over financial reporting could have a material adverse impact on our ability to report our financial statements in an accurate and timely manner, could subject us to regulatory actions, civil or criminal penalties, shareholder litigation, or loss of customer confidence, which could result in an adverse reaction in the financial

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marketplace due to a loss of investor confidence in the reliability of our financial statements, which ultimately could negatively impact our stock price.

A significant portion of our revenue is derived, and a significant portion of our research and development activities are based, outside the United States. Our results could be harmed by economic, political, regulatory and other risks associated with these international regions.

Because we operate worldwide, our business is subject to risks associated with doing business internationally. We anticipate that revenue from international operations could increase in the future. Most of our international revenue is generated by sales in Europe and Asia. In addition, some of our products are developed and manufactured outside the United States and we have a large number of employees in India that provide transcription services. A significant portion of the development and manufacturing of our voice and language products is conducted in Belgium and Canada, and a significant portion of our imaging research and development is conducted in Hungary. We also have significant research and development resources in Aachen, Germany, and Vienna, Austria. Accordingly, our future results could be harmed by a variety of factors associated with international sales and operations, including:

- changes in a specific country s or region s economic conditions;
- geopolitical turmoil, including terrorism and war;
- trade protection measures and import or export licensing requirements imposed by the United States or by other countries;
- compliance with foreign and domestic laws and regulations;
- negative consequences from changes in applicable tax laws;
- difficulties in staffing and managing operations in multiple locations in many countries;
- difficulties in collecting trade accounts receivable in other countries; and
- less effective protection of intellectual property than in the United States.

We are exposed to fluctuations in foreign currency exchange rates.

Because we have international subsidiaries and distributors that operate and sell our products outside the United States, we are exposed to the risk of changes in foreign currency exchange rates. In certain circumstances, we have entered into forward exchange contracts to hedge against foreign currency fluctuations. We use these contracts to reduce our risk associated with exchange rate movements, as the gains or losses on these contracts are intended to offset any exchange rate losses or gains on the hedged transaction. We do not engage in foreign currency speculation. Forward exchange contracts hedging firm commitments qualify for hedge accounting when they are designated as a hedge of the foreign currency exposure and they are effective in minimizing such exposure. With our increased international presence in a number of geographic locations and with international revenue and costs projected to increase, we are exposed to changes in foreign currencies including the euro, British Pound, Canadian Dollar, Japanese Yen, Indian Rupee, Singapore Dollar, Australian Dollar, Chinese Yuan, Israel Shekel, and the Hungarian Forint. Changes in the value of the euro or other foreign currencies relative to the value of the U.S. dollar could adversely affect future revenue and operating results.

Impairment of our intangible assets could result in significant charges that would adversely impact our future operating results.

We have significant intangible assets, including goodwill and intangibles with indefinite lives, which are susceptible to valuation adjustments as a result of changes in various factors or conditions. The most significant intangible assets are patents and core technology, completed technology, customer relationships and trademarks. Customer relationships are amortized on an accelerated basis based upon the pattern in which the economic benefits of customer relationships are being utilized. Other identifiable intangible assets are amortized on a straight-line basis over their estimated useful lives. We assess the potential impairment of identifiable intangible assets on an annual basis, as well as whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors that could trigger an impairment of such assets, include the following:

- significant underperformance relative to historical or projected future operating results;
- significant changes in the manner of or use of the acquired assets or the strategy for our overall business;
- significant negative industry or economic trends;
- significant decline in our stock price for a sustained period;
- changes in our organization or management reporting structure that could result in additional reporting units, which may require alternative methods of estimating fair values or greater disaggregation or aggregation in our analysis by reporting unit; and
- a decline in our market capitalization below net book value.

Future adverse changes in these or other unforeseeable factors could result in an impairment charge that would impact our results of operations and financial position in the reporting period identified.

Our sales to government clients subject us to risks, including early termination, audits, investigations, sanctions and penalties.

We derive a portion of our revenues from contracts with the United States government, as well as various state and local governments, and their respective agencies. Government contracts are generally subject to audits and investigations which could identify violations of these agreements. Government contract violations could result in a range of consequences including, but not limited to, contract price adjustments, civil and criminal penalties, contract termination, forfeiture of profit and/or suspension of payment, and suspension or debarment from future government contracts. We could also suffer serious harm to our reputation if we were found to have violated the terms of our government contracts.

We conducted an analysis of our compliance with the terms and conditions of certain contracts with the U.S. General Services Administration (GSA). Based upon our analysis, we voluntarily notified GSA of non-compliance with the terms of two contracts. The final resolution of this matter may adversely impact our financial position.

If we are unable to attract and retain key personnel, our business could be harmed.

If any of our key employees were to leave, we could face substantial difficulty in hiring qualified successors and could experience a loss in productivity while any successor obtains the necessary training and experience. Our employment relationships are generally at-will and we have had key employees leave in the past. We cannot assure you that one or more key employees will not leave in the future. We intend to continue to hire additional highly qualified personnel, including software engineers and operational personnel, but may not be able to attract, assimilate or retain qualified personnel in the future. Any failure to attract, integrate, motivate and retain these employees could harm our business.

Our medical transcription services may be subject to legal claims for failure to comply with laws governing the confidentiality of medical records.

Healthcare professionals who use our medical transcription services deliver to us health information about their patients including information that constitutes a record under applicable law that we may store on our computer systems. Numerous federal and state laws and regulations, the common law and contractual obligations govern collection, dissemination, use and confidentiality of patient-identifiable health information, including:

- state and federal privacy and confidentiality laws;
- our contracts with customers and partners;
- state laws regulating healthcare professionals;

Medicaid laws; and

the Health Insurance Portability and Accountability Act of 1996 and related rules proposed by the Health Care Financing Administration.

The Health Insurance Portability and Accountability Act of 1996 establishes elements including, but not limited to, federal privacy and security standards for the use and protection of protected health information. Any failure by us or by our personnel or partners to comply with applicable requirements may result in a material liability. Although we have systems and policies in place for safeguarding protected health information from unauthorized disclosure, these systems and policies may not preclude claims against us for alleged violations of applicable requirements. There can be no assurance that we will not be subject to liability claims that could have a material adverse affect on our business, results of operations and financial condition.

Adverse changes in general economic or political conditions in any of the major countries in which we do business could adversely affect our operating results.

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in domestic and global economic and political conditions. For example, the direction and relative strength of the U.S. and global economies have recently been increasingly uncertain due to softness in housing markets, extreme volatility in security prices, severely diminished liquidity and credit availability, rating downgrades of certain investments and declining valuations of others and continuing geopolitical uncertainties. If economic growth in the United States and other countries in which we do business is slowed, customers may delay or reduce technology purchases and may be unable to obtain credit to finance the purchase of our products. This could result in reduced sales of our products, longer sales cycles, slower adoption of new technologies and increased price competition. Any of these events would likely harm our business, results of operations and financial condition. Political instability in any of the major countries in which we do business would also likely harm our business, results of operations and financial condition.

Current uncertainty in the global financial markets and the global economy may negatively affect our financial results.

Current uncertainty in the global financial markets and economy may negatively affect our financial results. These macroeconomic developments could negatively affect our business, operating results or financial condition in a number of ways which, in turn, could adversely affect our stock price. A prolonged period of economic decline could have a material adverse effect on our results of operations and financial condition and exacerbate some of the other risk factors described herein. Our customers may defer purchases of our products, licenses, and services in response to tighter credit and negative financial news or reduce their demand for them. Our customers may also not be able to obtain adequate access to credit, which could affect their ability to make timely payments to us or ultimately cause the customer to file for protection from creditors under applicable insolvency or bankruptcy laws. If our customers are not able to make timely payments to us, our accounts receivable could increase.

Our investment portfolio, which includes short-term debt securities, is generally subject to credit, liquidity, counterparty, market and interest rate risks that may be exacerbated by the recent global financial crisis. If the banking system or the fixed income, credit or equity markets deteriorate or remain volatile, our investment portfolio may be impacted and the values and liquidity of our investments could be adversely affected.

In addition, our operating results and financial condition could be negatively affected if, as a result of economic conditions, either:

the demand for, and prices of, our products, licenses, or services are reduced as a result of actions by our competitors or otherwise; or

our financial counterparties or other contractual counterparties are unable to, or do not, meet their contractual commitments to us.

Security and privacy breaches in our systems may damage client relations and inhibit our growth.

The uninterrupted operation of our hosted solutions and the confidentiality and security of third-party information is critical to our business. Any failures in our security and privacy measures could have a material adverse effect on our financial position and results of operations. If we are unable to protect, or our clients perceive that we are unable to protect, the security and privacy of our electronic information, our growth could be materially adversely affected. A security or privacy breach may:

- cause our clients to lose confidence in our solutions;
- harm our reputation;
- expose us to liability; and
- increase our expenses from potential remediation costs.

While we believe we use proven applications designed for data security and integrity to process electronic transactions, there can be no assurance that our use of these applications will be sufficient to address changing market conditions or the security and privacy concerns of existing and potential clients.

Risks Related to Our Intellectual Property and Technology

Unauthorized use of our proprietary technology and intellectual property could adversely affect our business and results of operations.

Our success and competitive position depend in large part on our ability to obtain and maintain intellectual property rights protecting our products and services. We rely on a combination of patents, copyrights, trademarks, service marks, trade secrets, confidentiality provisions and licensing arrangements to establish and protect our intellectual property and proprietary rights. Unauthorized parties may attempt to copy aspects of our products or to obtain, license, sell or otherwise use information that we regard as proprietary. Policing unauthorized use of our products is difficult and we may not be able to protect our technology from unauthorized use. Additionally, our competitors may independently develop technologies that are substantially the same or superior to our technologies and that do not infringe our rights. In these cases, we would be unable to prevent our competitors from selling or licensing these similar or superior technologies. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as the laws of the United States. Although the source code for our proprietary software is protected both as a trade secret and as a copyrighted work, litigation may be necessary to enforce our intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Litigation, regardless of the outcome, can be very expensive and can divert management efforts.

Third parties have claimed and may claim in the future that we are infringing their intellectual property, and we could be exposed to significant litigation or licensing expenses or be prevented from selling our products if such claims are successful.

From time to time, we are subject to claims that we or our customers may be infringing or contributing to the infringement of the intellectual property rights of others. We may be unaware of intellectual property rights of others that may cover some of our technologies and products. If it appears necessary or desirable, we may seek licenses for these intellectual property rights. However, we may not be able to obtain licenses from some or all claimants, the terms of any offered licenses may not be acceptable to us, and we may not be able to resolve disputes without litigation. Any litigation regarding intellectual property could be costly and time-consuming and could divert the attention of our management and key personnel from our business operations. In the event of a claim of intellectual property infringement, we may be required to enter into costly royalty or license agreements. Third parties claiming intellectual property infringement may be able to obtain injunctive or other equitable relief that could effectively block our ability to develop and sell our products.

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We may incur substantial costs enforcing or acquiring intellectual property rights and defending against third-party claims as a result of litigation or other proceedings.

In connection with the enforcement of our own intellectual property rights, the acquisition of third-party intellectual property rights, or disputes relating to the validity or alleged infringement of third-party intellectual property rights, including patent rights, we have been, are currently, and may in the future be, subject to claims, negotiations or complex, protracted litigation. Intellectual property disputes and litigation are typically very costly and can be disruptive to our business operations by diverting the attention and energy of management and key technical personnel. Although we have successfully defended or resolved past litigation and disputes, we may not prevail in any ongoing or future litigation and disputes. In addition, we may incur significant costs in acquiring the necessary third party intellectual property rights for use in our products. Third party intellectual property disputes could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from manufacturing or licensing certain of our products, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers including contractual provisions under various license arrangements. Any of these could seriously harm our business.

Our software products may have bugs, which could result in delayed or lost revenue, expensive correction, liability to our customers and claims against us.

Complex software products such as ours may contain errors, defects or bugs. Defects in the solutions or products that we develop and sell to our customers could require expensive corrections and result in delayed or lost revenue, adverse customer reaction and negative publicity about us or our products and services. Customers who are not satisfied with any of our products may also bring claims against us for damages, which, even if unsuccessful, would likely be time-consuming to defend, and could result in costly litigation and payment of damages. Such claims could harm our reputation, financial results and competitive position.

Risks Related to our Corporate Structure, Organization and Common Stock

The holdings of our largest stockholder may enable it to influence matters requiring stockholder approval.

As of June 30, 2011, Warburg Pincus, a global private equity firm, beneficially owned approximately 23% of our outstanding common stock, including warrants exercisable for up to 7,562,422 shares of our common stock, and 3,562,238 shares of our outstanding Series B Preferred Stock, each of which is convertible into one share of our common stock. Because of its large holdings of our capital stock relative to other stockholders, this stockholder has a strong influence over matters requiring approval by our stockholders.

The market price of our common stock has been and may continue to be subject to wide fluctuations, and this may make it difficult for you to resell the common stock when you want or at prices you find attractive.

Our stock price historically has been, and may continue to be, volatile. Various factors contribute to the volatility of our stock price, including, for example, quarterly variations in our financial results, new product introductions by us or our competitors and general economic and market conditions. Sales of a substantial number of shares of our common stock by our largest stockholders, or the perception that such sales could occur, could also contribute to the volatility or our stock price. While we cannot predict the individual effect that these factors may have on the market price of our common stock, these factors, either individually or in the aggregate, could result in significant volatility in our stock price during any given period of time. Moreover, companies that have experienced volatility in the market price of their stock often are subject to securities class action litigation. If we were the subject of such litigation, it could result in substantial costs and divert management s attention and resources.

Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Reform and Consumer Protection Act, new regulations promulgated by the Securities and Exchange Commission and the rules of the Nasdaq Marketplace, are resulting in increased general and administrative expenses for companies such as ours. These new or changed laws, regulations and standards are subject to varying interpretations in many cases, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, we intend to invest resources to comply with evolving laws, regulations and standards, and this investment may result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies, our business may be harmed.

Future sales of our common stock in the public market could adversely affect the trading price of our common stock and our ability to raise funds in new stock offerings.

Future sales of substantial amounts of our common stock in the public market, or the perception that such sales could occur, could adversely affect prevailing trading prices of our common stock and could impair our ability to raise capital through future offerings of equity or equity-related securities. In connection with past acquisitions, we issued a substantial number of shares of our common stock as transaction consideration. We may continue to issue equity securities for future acquisitions, which would dilute existing stockholders, perhaps significantly depending on the terms of such acquisitions. For example, we issued, and registered for resale, approximately 2.3 million shares of our common stock in connection with our December 2009 acquisition of SpinVox. No prediction can be made as to the effect, if any, that future sales of shares of common stock, or the availability of shares of common stock for future sale, will have on the trading price of our common stock.

We have implemented anti-takeover provisions, which could discourage or prevent a takeover, even if an acquisition would be beneficial to our stockholders.

Provisions of our certificate of incorporation, bylaws and Delaware law, as well as other organizational documents could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. These provisions include:

- authorized blank check preferred stock;
- prohibiting cumulative voting in the election of directors;
- limiting the ability of stockholders to call special meetings of stockholders;
- requiring all stockholder actions to be taken at meetings of our stockholders; and
- establishing advance notice requirements for nominations of directors and for stockholder proposals.

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

None

Item 3. ***Defaults Upon Senior Securities***

None.

Item 5. ***Other Information***

None.

Item 6. ***Exhibits***

The exhibits listed on the Exhibit Index are filed or incorporated by reference (as stated therein) as part of this Quarterly Report on Form 10-Q.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized, in the Town of Burlington, Commonwealth of Massachusetts, on August 9, 2011.

Nuance Communications, Inc.

By: /s/ Thomas L. Beaudoin

Thomas L. Beaudoin
Executive Vice President and Chief Financial Officer

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EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Filed Herewith
2.1	Share Purchase Agreement, dated as of June 6, 2011, by and among Nuance, Ruetli Holding Corporation, the shareholders of SVOX and smac partners GmbH, as the shareholder representative.					X
2.2	Agreement and Plan of Merger, dated as of May 10, 2011, by and among Nuance, Ellipse Acquisition Corporation, Equitrac Corporation, U.S. Bank National Association, as escrow agent, and Cornerstone Equity Investors, LLC, as the stockholder representative.					X
3.1	Amended and Restated Certificate of Incorporation of the Registrant.	10-Q	0-27038	3.2	5/11/2001	
3.2	Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Registrant.	10-Q	0-27038	3.1	8/9/2004	
3.3	Certificate of Ownership and Merger.	8-K	0-27038	3.1	10/19/2005	
3.4	Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Registrant.	S-3	333-142182	3.3	4/18/2007	
3.5	Amended and Restated Bylaws of the Registrant.	10-K	0-27038	3.2	3/15/2004	
10.1	Letter dated March 14, 2011 to Bill Nelson regarding certain employment matters					X
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a).					X
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a).					X
32.1	Certification Pursuant to 18 U.S.C. Section 1350.					X
101	The following materials from Nuance Communications, Inc. s Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Operations, (ii) the Consolidated Balance Sheets, (iii) the					X

Consolidated Statements of Cash Flows, and (iv) Notes of Consolidated Financial Statements.