

Edgar Filing: Nuance Communications, Inc. - Form 10-Q

Nuance Communications, Inc.
Form 10-Q
May 10, 2017
Table of Contents

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

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2017

Or

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

Commission file number 001-36056

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

Delaware	94-3156479
(State or Other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1 Wayside Road	01803
Burlington, Massachusetts	(Zip Code)
(Address of principal executive offices)	
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 No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. Yes No

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

The number of shares of the Registrant's Common Stock, outstanding as of April 28, 2017 was 287,655,022.

NUANCE COMMUNICATIONS, INC.
TABLE OF CONTENTS

	Page
<u>PART I: FINANCIAL INFORMATION</u>	
Item 1. Condensed Consolidated Financial Statements (unaudited):	
a) Consolidated Statements of Operations for the three and six months ended March 31, 2017 and 2016	1
Consolidated Statements of Comprehensive (Loss) Income for the three and six months ended	
b) March 31, 2017 and 2016	2
c) Consolidated Balance Sheets at March 31, 2017 and September 30, 2016	3
d) Consolidated Statements of Cash Flows for the six months ended March 31, 2017 and 2016	4
e) <u>Notes to Condensed Consolidated Financial Statements</u>	5
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	23
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	42
Item 4. <u>Controls and Procedures</u>	43
<u>PART II: OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	43
Item 1A. <u>Risk Factors</u>	44
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	52
Item 3. <u>Defaults Upon Senior Securities</u>	52
Item 4. <u>Mine Safety Disclosures</u>	52
Item 5. <u>Other Information</u>	53
Item 6. <u>Exhibits</u>	53
<u>Signatures</u>	54
<u>Exhibit Index</u>	55
Certifications	

Part I. Financial Information

Item 1. Condensed Consolidated Financial Statements (unaudited)

NUANCE COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31,		Six Months Ended March 31,	
	2017	2016	2017	2016
	(Unaudited)			
	(In thousands, except per share amounts)			
Revenues:				
Professional services and hosting	\$258,690	\$240,196	\$512,107	\$467,331
Product and licensing	159,258	158,622	311,010	337,672
Maintenance and support	81,625	79,915	164,114	159,845
Total revenues	499,573	478,733	987,231	964,848
Cost of revenues:				
Professional services and hosting	164,170	154,712	329,062	307,971
Product and licensing	18,790	20,823	37,168	44,235
Maintenance and support	13,240	13,626	26,838	26,922
Amortization of intangible assets	17,218	16,339	32,760	31,970
Total cost of revenues	213,418	205,500	425,828	411,098
Gross profit	286,155	273,233	561,403	553,750
Operating expenses:				
Research and development	66,232	67,226	132,554	137,751
Sales and marketing	93,674	92,837	195,190	193,427
General and administrative	41,518	45,940	81,308	86,441
Amortization of intangible assets	27,912	26,448	55,771	53,481
Acquisition-related costs, net	5,379	1,225	14,405	3,705
Restructuring and other charges, net	19,911	6,652	26,614	14,540
Total operating expenses	254,626	240,328	505,842	489,345
Income from operations	31,529	32,905	55,561	64,405
Other income (expense):				
Interest income	1,280	1,616	2,303	2,499
Interest expense	(37,853)	(32,328)	(75,874)	(62,208)
Other (expense) income, net	(19,623)	6	(20,232)	(6,795)
(Loss) income before income taxes	(24,667)	2,199	(38,242)	(2,099)
Provision for income taxes	9,141	9,245	19,494	17,012
Net loss	\$(33,808)	\$(7,046)	\$(57,736)	\$(19,111)
Net loss per share:				
Basic	\$(0.12)	\$(0.02)	\$(0.20)	\$(0.06)
Diluted	\$(0.12)	\$(0.02)	\$(0.20)	\$(0.06)
Weighted average common shares outstanding:				
Basic	291,021	298,021	289,976	303,050
Diluted	291,021	298,021	289,976	303,050

See accompanying notes.

NUANCE COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

	Three Months		Six Months Ended	
	Ended March 31,		March 31,	
	2017	2016	2017	2016
	(Unaudited)			
	(In thousands)			
Net loss	\$(33,808)	\$(7,046)	\$(57,736)	\$(19,111)
Other comprehensive income (loss):				
Foreign currency translation adjustment	17,947	17,567	(12,619)	8,663
Pension adjustments	118	76	236	150
Unrealized gain (loss) on marketable securities	27	100	(4)	33
Total other comprehensive income (loss), net	18,092	17,743	(12,387)	8,846
Comprehensive (loss) income	\$(15,716)	\$10,697	\$(70,123)	\$(10,265)

See accompanying notes.

2

Table of ContentsNUANCE COMMUNICATIONS, INC.
CONSOLIDATED BALANCE SHEETS

	March 31, 2017	September 30, 2016
	(Unaudited)	
	(In thousands, except per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$625,640	\$481,620
Marketable securities	160,836	98,840
Accounts receivable, less allowances for doubtful accounts of \$11,998 and \$11,038	385,895	380,004
Prepaid expenses and other current assets	92,411	78,126
Total current assets	1,264,782	1,038,590
Marketable securities	44,697	27,632
Land, building and equipment, net	167,985	185,169
Goodwill	3,525,899	3,508,879
Intangible assets, net	735,965	762,220
Other assets	135,023	138,980
Total assets	\$5,874,351	\$5,661,470
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$366,604	\$—
Contingent and deferred acquisition payments	29,795	9,468
Accounts payable	98,290	94,599
Accrued expenses and other current liabilities	194,928	237,659
Deferred revenue	390,039	349,173
Total current liabilities	1,079,656	690,899
Long-term portion of debt	2,217,869	2,433,152
Deferred revenue, net of current portion	412,363	386,960
Deferred tax liabilities	125,282	115,435
Other liabilities	89,511	103,694
Total liabilities	3,924,681	3,730,140
Commitments and contingencies (Note 15)		
Stockholders' equity:		
Common stock, \$0.001 par value per share; 560,000 shares authorized; 291,370 and 291,384 shares issued and 287,619 and 287,633 shares outstanding, respectively	291	291
Additional paid-in capital	2,581,454	2,492,992
Treasury stock, at cost (3,751 shares)	(16,788)	(16,788)
Accumulated other comprehensive loss	(128,521)	(116,134)
Accumulated deficit	(486,766)	(429,031)
Total stockholders' equity	1,949,670	1,931,330
Total liabilities and stockholders' equity	\$5,874,351	\$5,661,470
See accompanying notes.		

Table of ContentsNUANCE COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended March 31, 2017 2016 (Unaudited) (In thousands)	
Cash flows from operating activities:		
Net loss	\$(57,736)	\$(19,111)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	116,644	115,826
Stock-based compensation	79,478	80,511
Non-cash interest expense	26,771	21,215
Deferred tax provision	5,643	3,738
Loss on extinguishment of debt	18,565	4,851
Other	13,286	(135)
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	(1,431)	22,110
Prepaid expenses and other assets	(12,295)	(16,765)
Accounts payable	(1,000)	2,697
Accrued expenses and other liabilities	(10,579)	7,334
Deferred revenue	72,988	78,792
Net cash provided by operating activities	250,334	301,063
Cash flows from investing activities:		
Capital expenditures	(18,787)	(32,235)
Payments for business and asset acquisitions, net of cash acquired	(72,990)	(27,399)
Purchases of marketable securities and other investments	(153,851)	(32,757)
Proceeds from sales and maturities of marketable securities and other investments	69,658	32,681
Net cash used in investing activities	(175,970)	(59,710)
Cash flows from financing activities:		
Payments of debt	(634,055)	(511,844)
Proceeds from issuance of long-term debt, net of issuance costs	838,959	663,757
Payments for repurchase of common stock	(99,077)	(574,338)
Net payments on other long-term liabilities	(206)	(1,084)
Proceeds from issuance of common stock from employee stock plans	8,598	8,440
Cash used to net share settle employee equity awards	(43,353)	(56,973)
Net cash provided by (used in) financing activities	70,866	(472,042)
Effects of exchange rate changes on cash and cash equivalents	(1,210)	1,930
Net increase (decrease) in cash and cash equivalents	144,020	(228,759)
Cash and cash equivalents at beginning of period	481,620	479,449
Cash and cash equivalents at end of period	\$625,640	\$250,690
See accompanying notes.		

Table of Contents

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Presentation

The consolidated financial statements include the accounts of Nuance Communications, Inc. (“Nuance”, “we”, “our”, or “the Company”) and our wholly-owned subsidiaries. We prepared these unaudited interim consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (the “U.S.” or the “United States”) and pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). The condensed consolidated financial statements reflect all adjustments that, in our opinion, are necessary to present fairly our financial position, results of operations and cash flows for the periods indicated. The preparation of financial statements in conformity with U.S. Generally Accepted Accounting Principles (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts and classifications of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Although we believe the disclosures in these financial statements are adequate to make the information presented not misleading, certain information in the footnote disclosures of the financial statements has been condensed or omitted where it substantially duplicates information provided in our latest audited consolidated financial statements, in accordance with the rules and regulations of the SEC. 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, 2016. The results of operations for the three and six months ended March 31, 2017 and 2016, respectively, are not necessarily indicative of the results for the entire fiscal year or any future period. We have evaluated subsequent events from March 31, 2017 through the date of the issuance of these consolidated financial statements and have determined that no material subsequent events have occurred that would affect the information presented in these consolidated financial statements.

2. Summary of Significant Accounting Policies

Recently Adopted Accounting Standards

In January 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2017-01, “Clarifying the Definition of a Business” (“ASU 2017-01”), which provides guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 requires entities to use a screen test to determine when an integrated set of assets and activities is not a business or if the integrated set of assets and activities needs to be further evaluated against the framework. ASU 2017-01 is effective for fiscal years beginning after December 15, 2017, including interim periods within those years, with early adoption permitted. Effective January 2017, we early adopted the guidance and the adoption had no material impact on our consolidated financial statements.

Effective October 1, 2016, we implemented ASU No. 2015-02, “Amendments to the Consolidation Analysis” (“ASU 2015-02”). The amendments in ASU 2015-02 provide guidance on evaluating whether a company should consolidate certain legal entities. In accordance with the guidance, all legal entities are subject to reevaluation under the revised consolidation model. The implementation of ASU 2015-02 had no impact on our consolidated financial statements.

Effective October 1, 2016, we implemented ASU No. 2014-15, “Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern” (“ASU 2014-15”), to provide guidance on management’s responsibility in evaluating whether there is substantial doubt about a company’s ability to continue as a going concern and to provide related footnote disclosures. The implementation of ASU 2014-15 had no impact on our consolidated financial statements.

Effective October 1, 2016, we implemented ASU No. 2014-12, “Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period” (“ASU 2014-12”). ASU 2014-12 requires that a performance target that affects vesting and could be achieved after the requisite service period be treated as a performance condition. The implementation of ASU 2014-12 had no impact on our consolidated financial statements.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Recently Issued Accounting Standards

From time to time, new accounting pronouncements are issued by the FASB and are adopted by us as of the specified effective dates. Unless otherwise discussed, such pronouncements did not have or will not have a significant impact on our consolidated financial position, results of operations and cash flows or do not apply to our operations.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15"), which provides guidance on the classification of certain specific cash flow issues including debt prepayment or extinguishment costs, settlement of certain debt instruments, contingent consideration payments made after a business combination, proceeds from the settlement of certain insurance claims and distributions received from equity method investees. The standard requires the use of a retrospective approach to all periods presented, but may be applied prospectively if retrospective application would be impracticable. ASU 2016-15 is effective for us in the first quarter of fiscal year 2019, and early application is permitted. We are currently evaluating the impact of our pending adoption of ASU 2016-15 on our statement of cash flows, but do not expect it to have a material impact.

In March 2016, the FASB issued ASU No. 2016-09, "Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"), which is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax effects, statutory withholding requirements, forfeitures, and classification on the statement of cash flows. ASU 2016-09 is effective for us in the first quarter of fiscal year 2018, and early application is permitted. We are currently evaluating the impact of our pending adoption of ASU 2016-09 on our consolidated financial statements but do not expect it to have a material impact.

In February 2016, the FASB issued ASU No. 2016-02, "Leases" ("ASU 2016-02"). ASU 2016-02 requires lessees to recognize on the balance sheet a right-of-use asset, representing its right to use the underlying asset for the lease term, and a lease liability for all leases with terms greater than 12 months. The guidance also requires qualitative and quantitative disclosures designed to assess the amount, timing, and uncertainty of cash flows arising from leases. The standard requires the use of a modified retrospective transition approach, which includes a number of optional practical expedients that entities may elect to apply. ASU 2016-02 is effective for us in the first quarter of fiscal year 2020, and early application is permitted. We are currently evaluating the impact of our pending adoption of ASU 2016-02 on our consolidated financial statements and we currently expect that most of our operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon our adoption of ASU 2016-02, which will increase our total assets and total liabilities that we report relative to such amounts prior to adoption.

In January 2016, the FASB issued ASU No. 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities" ("ASU 2016-01"). ASU 2016-01 amends the guidance on the classification and measurement of financial instruments. Although ASU 2016-01 retains many current requirements, it significantly revises accounting related to the classification and measurement of investments in equity securities and the presentation of certain fair value changes for financial liabilities measured at fair value. ASU 2016-01 also amends certain disclosure requirements associated with the fair value of financial instruments and is effective for us in the first quarter of fiscal year 2019. Based on the composition of our investment portfolio, we do not believe the adoption of ASU 2016-01 will have a material impact on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers: Topic 606" ("ASU 2014-09"), to supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. ASU 2014-09 permits two methods of adoption: (i) retrospective to each prior reporting period presented; or (ii) retrospective with the cumulative effect

of initially applying the guidance recognized at the date of initial application. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date, which deferred the effective date of the new revenue standard for periods beginning after December 15, 2016 to December 15, 2017, with early adoption permitted but not earlier than the original effective date. Accordingly, the updated standard is effective for us in the first quarter of fiscal 2019 and we do not plan to early adopt. In the first quarter of fiscal 2017, we commenced a project to assess the potential impact of the new standard on our consolidated financial statements and related disclosures. This project also includes the assessment and enhancement of our internal processes and systems to address the new standard. We have not yet selected a transition method.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

3. Business Acquisitions

As part of our business strategy, we have acquired, and may acquire in the future, certain businesses and technologies primarily to expand our products and service offerings.

Fiscal Year 2017 Acquisitions

In fiscal year 2017, we acquired several businesses in our Enterprise, Healthcare and Mobile segments that were not significant individually or in the aggregate. The total aggregate consideration for these acquisitions was \$53.5 million, including the issuance of 0.8 million shares of our common stock valued at \$13.4 million and a \$3.3 million estimated fair value for future contingent payments. The results of operations of these acquisitions have been included in our financial results since their respective acquisition dates.

The fair value estimates for the assets acquired and liabilities assumed for acquisitions completed during fiscal year 2017 were based upon preliminary calculations and valuations, and our estimates and assumptions for each of these acquisitions are subject to change as we obtain additional information during the respective measurement periods (up to one year from the respective acquisition dates). The primary areas of preliminary estimates that were not yet finalized related to certain assets and liabilities acquired. There were no significant changes to the fair value estimates during the current year.

We have not furnished pro forma financial information related to our current year acquisitions because such information is not material, individually or in the aggregate, to our financial results. We have also not presented revenue or the results of operations for each of these business combinations, from the date of acquisition, as they were similarly neither material nor significant to our consolidated financial results.

Fiscal Year 2016 Acquisitions

Acquisition of TouchCommerce, Inc.

In August 2016, we acquired all of the outstanding stock of TouchCommerce. TouchCommerce is a provider of omni-channel solutions to engage their customers on any device through online chat, guides, personalized content, and other automated tools, resulting in enhanced customer experience, increased revenue and reduced support costs. We expect this acquisition to expand our customer care solutions with a range of new digital engagement offerings, including live chat, customer analytics and personalization solutions within our Enterprise segment. We expect to be able to provide an end-to-end engagement platform that merges intelligent self-service with assisted service to increase customer satisfaction, strengthen customer loyalty and improve business results. The aggregate consideration for this transaction was \$218.1 million, and included \$113.0 million paid in cash and \$85.0 million paid in our common stock. The remaining \$20.1 million is expected to be paid in November 2017 at the conclusion of an indemnity period in either cash or our common stock, at our election. The acquisition was a stock purchase and the goodwill resulting from this acquisition is not deductible for tax purposes. The results of operations for this acquisition have been included in our Enterprise segment from the acquisition date.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

A summary of the preliminary allocation of the purchase consideration for our TouchCommerce acquisition is as follows (dollars in thousands):

	Touch-Commerce
Purchase consideration:	
Cash	\$ 113,008
Common stock ^(a)	85,000
Deferred acquisition payment	20,140
Total purchase consideration	\$ 218,148

Allocation of the purchase consideration:

Cash	\$ 137	
Accounts receivable ^(b)	14,897	
Goodwill	117,924	
Identifiable intangible assets ^(c)	110,800	
Other assets	1,521	
Total assets acquired	245,279	
Current liabilities	(4,198)
Deferred tax liability	(19,515)
Deferred revenue	(2,784)
Other long term liabilities	(634)
Total liabilities assumed	(27,131)
Net assets acquired	\$ 218,148	

(a) 5,749,807 shares of our common stock valued at \$14.78 per share were issued at closing.

(b) Accounts receivable have been recorded at their estimated fair values and the fair value reserve was not material.

(c) The following are the identifiable intangible assets acquired and their respective weighted average useful lives, as determined based on preliminary valuations (dollars in thousands):

	TouchCommerce	Weighted
	Amount	Average
		Life
		(Years)
Core and completed technology	\$26,000	6.0
Customer relationships	81,600	10.0
Trade names	3,200	5.0
Total	\$110,800	

Other Fiscal Year 2016 Acquisitions

During fiscal year 2016, we acquired several other businesses in our Healthcare segment that were not significant individually or in the aggregate. The total aggregate cash consideration for these acquisitions was \$50.4 million including an estimated fair value for future contingent payments. The results of operations of these acquisitions have been included in our financial results since their respective acquisition dates.

Acquisition-Related Costs, net

Acquisition-related costs include costs related to business and other acquisitions, including potential acquisitions. These costs consist of (i) 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 activities, including services provided by third-parties; (ii) professional service fees and expenses, including financial advisory, legal,

accounting, and other outside services incurred in

8

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

connection with acquisition activities, and disputes and regulatory matters related to acquired entities; and (iii) 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, such as gains or losses on settlements of pre-acquisition contingencies.

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2017	2016	2017	2016
Transition and integration costs	\$3,612	\$1,039	\$7,322	\$2,035
Professional service fees	2,974	1,197	7,991	2,600
Acquisition-related adjustments	(1,207)	(1,011)	(908)	(930)
Total	\$5,379	\$1,225	\$14,405	\$3,705

4. Goodwill and Intangible Assets

The changes in the carrying amount of goodwill and intangible assets for the six months ended March 31, 2017, are as follows (dollars in thousands):

	Goodwill	Intangible Assets
Balance at September 30, 2016	\$3,508,879	\$762,220
Acquisitions	26,720	61,803
Purchase accounting adjustments	402	—
Amortization	—	(88,531)
Effect of foreign currency translation	(10,102)	473
Balance at March 31, 2017	\$3,525,899	\$735,965

During the first quarter of fiscal year 2017, we acquired a speech patent portfolio for total cash consideration of \$35.0 million which was paid in January 2017.

5. Financial Instruments and Hedging Activities

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 functional currency of our operations. We have a program that primarily utilizes foreign currency forward contracts to offset the risks associated with the effect of certain foreign currency exposures. Our program is designed so that increases or decreases in our foreign currency exposures are offset by gains or losses on the foreign currency forward contracts in order to mitigate the risks and volatility associated with our foreign currency transactions. Generally, we enter into such contracts for less than 90 days and have no cash requirements until maturity. At March 31, 2017 and September 30, 2016, we had outstanding contracts with a total notional value of \$69.3 million and \$215.2 million, respectively.

We have not designated these forward contracts as hedging instruments pursuant to the authoritative guidance for derivatives and hedging, and accordingly, we record the fair value of these contracts at the end of each reporting period in our consolidated balance sheet, with the unrealized gains and losses recognized immediately in earnings as other expense, net in our consolidated statements of operations. The cash flows related to the settlement of these contracts are included in cash flows from investing activities within our consolidated statement of cash flows.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table provides a quantitative summary of the fair value of our derivative instruments as of March 31, 2017 and September 30, 2016 (dollars in thousands):

Derivatives Not Designated as Hedges: Balance Sheet Classification	Fair Value	
	March 31, 2017	September 30, 2016
Foreign currency contracts	\$448	\$ 335
Prepaid expenses and other current assets	\$448	\$ 335
Net fair value of non-hedge derivative instruments	\$448	\$ 335

The following tables summarize the activity of derivative instruments for the six months ended March 31, 2017 and 2016 (dollars in thousands):

Derivatives Not Designated as Hedges	Location of Gain (Loss) Recognized in Income	Three Months Ended March 31,		Six Months Ended March 31,	
		2017	2016	2017	2016
Foreign currency contracts	Other expense (income), net	\$3,555	\$5,607	\$(8,060)	\$2,234
Other Financial Instruments					

Financial instruments including cash equivalents, accounts receivable and accounts payable are carried in the consolidated financial statements at amounts that approximate their fair value based on the short maturities of those instruments. Marketable securities and derivative instruments are carried at fair value.

6. 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.

The following summarizes the three levels of inputs required to measure fair value, 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 based on the best information available, including management's estimates and assumptions.

Assets and liabilities measured at fair value on a recurring basis at March 31, 2017 and September 30, 2016 consisted of (dollars in thousands):

	March 31, 2017			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds ^(a)	\$505,784	\$—	\$—	\$505,784
US government agency securities ^(a)	1,004	—	—	1,004
Time deposits ^(b)	—	83,172	—	83,172
Commercial paper, \$45,985 at cost ^(b)	—	46,018	—	46,018
Corporate notes and bonds, \$76,311 at cost ^(b)	—	76,343	—	76,343
Foreign currency exchange contracts ^(b)	—	448	—	448
Total assets at fair value	\$506,788	\$205,981	\$—	\$712,769
Liabilities:				
Contingent acquisition payments ^(c)	\$—	\$—	\$(6,377)	\$(6,377)

Total liabilities at fair value	\$—	\$—	\$(6,377)	\$(6,377)
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10

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	September 30, 2016			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds ^(a)	\$331,419	\$—	\$—	\$331,419
US government agency securities ^(a)	1,002	—	—	1,002
Time deposits ^(b)	—	33,794	—	33,794
Commercial paper, \$38,108 at cost ^(b)	—	38,142	—	38,142
Corporate notes and bonds, \$54,484 at cost ^(b)	—	54,536	—	54,536
Foreign currency exchange contracts ^(b)	—	335	—	335
Total assets at fair value	\$332,421	\$126,807	\$—	\$459,228
Liabilities:				
Contingent acquisition payments ^(c)	\$—	\$—	\$(8,240)	\$(8,240)
Total liabilities at fair value	\$—	\$—	\$(8,240)	\$(8,240)

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

The fair values of our time deposits, commercial paper, corporate notes and bonds, and foreign currency exchange contracts are based on the most recent observable inputs for similar instruments in active markets or quoted prices

(b) for identical or similar instruments in markets that are not active or are directly or indirectly observable. Time deposits are generally for terms of one year or less. The commercial paper and corporate notes and bonds mature within three years and have a weighted average maturity of 0.78 years as of March 31, 2017.

The fair values of our contingent consideration arrangements are determined based on our evaluation as to the

(c) probability and amount of any earn-out that will be achieved based on expected future performance by the acquired entity.

The following table provides a summary of changes in fair value of our Level 3 financial instruments for the six months ended March 31, 2017 and 2016 (dollars in thousands):

	Three Months		Six Months	
	Ended March 31, 2017	2016	Ended March 31, 2017	2016
Balance at beginning of period	\$8,961	\$16,901	\$8,240	\$15,961
Earn-out liabilities established at time of acquisition	1,600	2,500	3,253	2,500
Payments and foreign currency translation	(2,759)	910	(4,257)	1,372
Adjustments to fair value included in acquisition-related costs, net	(1,425)	514	(859)	992
Balance at end of period	\$6,377	\$20,825	\$6,377	\$20,825

Our financial liabilities valued based upon Level 3 inputs are composed of contingent consideration arrangements relating to our acquisitions. We are contractually obligated to pay contingent consideration to the selling shareholders upon the achievement of specified objectives, including the achievement of future bookings and sales targets related to the products of the acquired entities and therefore we record contingent consideration liabilities at the time of the acquisitions. We update our assumptions each reporting period based on new developments and record such amounts at fair value based on the revised assumptions until the consideration is paid upon the achievement of the specified objectives or eliminated upon failure to achieve the specified objectives.

Contingent acquisition payment liabilities are scheduled to be paid in periods through fiscal year 2019. As of March 31, 2017, we could be required to pay up to \$22.3 million for contingent consideration arrangements if the specified objectives are achieved. We have determined the fair value of the liabilities for the contingent consideration based on a probability-weighted discounted cash flow analysis. This fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement within the fair value hierarchy. The fair value of the contingent consideration liability associated with future payments was based on several factors, the

most significant of which are the estimated cash flows projected from future product sales and the risk adjusted discount rate for the fair value measurement.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

7. Accrued Expenses and Other Current Liabilities

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

	March 31, 2017	September 30, 2016
Compensation	\$ 111,410	\$ 154,028
Accrued interest payable	23,629	20,409
Cost of revenue related liabilities	17,639	19,351
Consulting and professional fees	16,083	18,001
Facilities related liabilities	8,600	7,382
Sales and marketing incentives	4,509	6,508
Sales and other taxes payable	2,083	2,708
Other	10,975	9,272
Total	\$ 194,928	\$ 237,659

8. Deferred Revenue

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/updates on a when-and-if-available basis. Unearned revenue includes fees for up-front set-up of the service environment; fees charged for on-demand service; 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.

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

	March 31, 2017	September 30, 2016
Current liabilities:		
Deferred maintenance revenue	\$ 166,650	\$ 165,902
Unearned revenue	223,389	183,271
Total current deferred revenue	\$ 390,039	\$ 349,173
Long-term liabilities:		
Deferred maintenance revenue	\$ 58,110	\$ 59,955
Unearned revenue	354,253	327,005
Total long-term deferred revenue	\$ 412,363	\$ 386,960

9. Restructuring and Other Charges, net

Restructuring and other charges, net include restructuring expenses together with other charges that are unusual in nature, are the result of unplanned events, and arise outside of the ordinary course of continuing operations.

Restructuring expenses consist of employee severance costs and may also include charges for excess facility space and other contract termination costs. Other charges may include litigation contingency reserves, costs related to a transition agreement for our Chief Executive Officer, asset impairment charge and gains or losses on the sale or disposition of certain non-strategic assets or product lines.

The following table sets forth accrual activity relating to restructuring reserves for the six months ended March 31, 2017 (dollars in thousands):

	Personnel	Facilities	Total
Balance at September 30, 2016	\$ 2,661	\$ 11,132	\$ 13,793
Restructuring charges, net	8,224	4,154	12,378
Non-cash adjustment	—	(79)	(79)
Cash payments	(8,264)	(3,968)	(12,232)
Balance at March 31, 2017	\$ 2,621	\$ 11,239	\$ 13,860

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

While restructuring and other charges, net are excluded from our calculation of segment profit, the table below presents the restructuring and other charges, net associated with each segment (dollars in thousands):

	Three Months Ended March 31, 2017				2016					
	Personnel	Facilities	Total Restructuring	Other Charges	Total	Personnel	Facilities	Total Restructuring	Other Charges	Total
Healthcare	\$577	\$ 593	\$ 1,170	\$—	\$1,170	\$613	\$ 8	\$ 621	\$ —	\$621
Mobile	3,053	51	3,104	10,773	13,877	2,729	(652)	2,077	46	2,123
Enterprise	388	257	645	—	645	(41)	2,014	1,973	—	1,973
Imaging	225	36	261	—	261	(1)	184	183	—	183
Corporate	332	1,318	1,650	2,308	3,958	1,691	—	1,691	61	1,752
Total	\$4,575	\$ 2,255	\$ 6,830	\$ 13,081	\$ 19,911	\$4,991	\$ 1,554	\$ 6,545	\$ 107	\$6,652

	Six Months Ended March 31, 2017				2016					
	Personnel	Facilities	Total Restructuring	Other Charges	Total	Personnel	Facilities	Total Restructuring	Other Charges	Total
Healthcare	\$2,561	\$ 870	\$ 3,431	\$—	\$3,431	\$1,314	\$ 8	\$ 1,322	\$ —	\$1,322
Mobile	3,265	51	3,316	10,773	14,089	4,911	(50)	4,861	46	4,907
Enterprise	812	864	1,676	—	1,676	1,043	2,034	3,077	—	3,077
Imaging	586	387	973	—	973	212	184	396	—	396
Corporate	1,000	1,982	2,982	3,463	6,445	2,069	2,708	4,777	61	4,838
Total	\$8,224	\$ 4,154	\$ 12,378	\$ 14,236	\$ 26,614	\$9,549	\$ 4,884	\$ 14,433	\$ 107	\$ 14,540

Fiscal Year 2017

During the three and six months ended March 31, 2017, we recorded restructuring charges of \$6.8 million and \$12.4 million, respectively. The restructuring charges for the six months ended March 31, 2017 included \$8.2 million for severance costs related to approximately 220 terminated employees and \$4.2 million charge for the closure of certain excess facility space including adjustment to sublease assumptions associated with prior abandoned facilities. These actions are part of our initiatives to reduce costs and optimize processes. We expect the remaining outstanding severance payments of \$2.6 million will be substantially paid by the end of fiscal year 2017. We expect the remaining payments of \$11.2 million for the closure of excess facility space will be paid through fiscal year 2025, in accordance with the terms of the applicable leases.

In addition to the restructuring charges, during the three and six months ended March 31, 2017, we recorded \$2.3 million and \$3.5 million, respectively, for costs related to a transition agreement for our Chief Executive Officer as communicated on our Form 8-K filed on November 17, 2016. The cash payments associated with the transition agreement are expected to be made during fiscal years 2018 and 2019. Also included in other charges is a non-cash impairment charge of \$10.8 million resulting from our decision to cease use of a capitalized internally developed software during the three months ended March 31, 2017.

Fiscal Year 2016

During the three and six months ended March 31, 2016, we recorded restructuring charges of \$6.5 million and \$14.4 million, respectively. The restructuring charges for the six months ended March 31, 2016 included \$9.5 million for severance costs related to approximately 200 terminated employees as part of our initiatives to reduce costs and optimize processes. The restructuring charges also included a \$4.9 million charge for the closure of certain excess facility space.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

10. Debt and Credit Facilities

At March 31, 2017 and September 30, 2016, we had the following long-term borrowing obligations (dollars in thousands):

	March 31, 2017	September 30, 2016
5.625% Senior Notes due 2026, net of deferred issuance costs of \$6.4 million. Effective interest rate 5.625%.	\$493,634	\$—
5.375% Senior Notes due 2020, net of unamortized premium of \$1.1 million and \$3.0 million, respectively, and deferred issuance costs of \$2.7 million and \$7.3 million, respectively. Effective interest rate 5.375%.	448,391	1,046,851
6.000% Senior Notes due 2024, net of deferred issuance costs of \$2.2 million and \$2.4 million, respectively. Effective interest rate 6.000%.	297,756	297,601
1.00% Convertible Debentures due 2035, net of unamortized discount of \$152.4 million and \$163.5 million, respectively, and deferred issuance costs of \$7.6 million and \$8.2 million, respectively. Effective interest rate 5.622%.	516,542	504,712
2.75% Convertible Debentures due 2031, net of unamortized discount of \$10.5 million and \$19.2 million, respectively, and deferred issuance costs of \$0.6 million and \$1.1 million, respectively. Effective interest rate 7.432%.	366,604	375,208
1.25% Convertible Debentures due 2025, net of unamortized discount of \$97.6 million, and deferred issuance costs of \$4.6 million. Effective interest rate 5.578%.	247,860	—
1.50% Convertible Debentures due 2035, net of unamortized discount of \$47.2 million and \$51.7 million, respectively, and deferred issuance costs of \$1.7 million and \$1.9 million, respectively. Effective interest rate 5.394%.	215,026	210,286
Deferred issuance costs related to our Revolving Credit Facility	(1,340)	(1,506)
Total long-term debt	\$2,584,473	\$2,433,152
Less: current portion	366,604	—
Non-current portion of long-term debt	\$2,217,869	\$2,433,152

The following table summarizes the maturities of our borrowing obligations as of March 31, 2017 (dollars in thousands):

Fiscal Year	Convertible Debentures ⁽¹⁾	Senior Notes	Total
2017	\$—	\$—	\$—
2018	377,740	—	377,740
2019	—	—	—
2020	—	450,000	450,000
2021	—	—	—
Thereafter	1,290,383	800,000	2,090,383
Total before unamortized discount	1,668,123	1,250,000	2,918,123
Less: unamortized discount and issuance costs	(322,091)	(11,559)	(333,650)
Total long-term debt	\$ 1,346,032	\$ 1,238,441	\$ 2,584,473

Holder of the 1.0% 2035 Debentures have the right to require us to redeem the debentures on December 15, 2022, 2027 and 2032. Holders of the 2031 Debentures have the right to require us to redeem the debentures on November 1, 2017, 2021, and 2026. Holders of the 1.5% 2035 Debentures have the right to require us to redeem the debentures on November 1, 2021, 2026, and 2031.

The estimated fair value of our long-term debt approximated \$2,941.7 million (face value \$2,918.1 million) and \$2,630.3 million (face value \$2,687.1 million) at March 31, 2017 and September 30, 2016, respectively. 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 will continue to vary each period based on fluctuations in market interest rates, as well as changes to our credit ratings. The Senior Notes and the Convertible Debentures are traded, and the fair values of each borrowing was estimated using the averages of the bid and ask trading quotes at each respective reporting date. We had no outstanding balance on the Revolving Credit Facility at March 31, 2017 or September 30, 2016.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

5.625% Senior Notes due 2026

In December 2016, we issued \$500.0 million aggregate principal amount of 5.625% Senior Notes due on December 15, 2026 (the "2026 Senior Notes") in a private placement. The proceeds from the 2026 Senior Notes were approximately \$495.0 million, net of issuance costs, and we used the proceeds to repurchase a portion of our 2020 Senior Notes. The 2026 Senior Notes bear interest at 5.625% per year, payable in cash semi-annually in arrears, beginning on June 15, 2017.

The 2026 Senior Notes are unsecured senior obligations and are guaranteed on an unsecured senior basis by certain of our domestic subsidiaries ("Subsidiary Guarantors"). The 2026 Senior Notes and the guarantees rank equally in right of payment with all of our and the Subsidiary Guarantors' existing and future unsecured senior debt and rank senior in right of payment to all of our and the Subsidiary Guarantors' future unsecured subordinated debt. The 2026 Senior Notes and guarantees effectively rank junior to all our secured debt and that of the Subsidiary Guarantors to the extent of the value of the collateral securing such debt and to all liabilities, including trade payables, of our subsidiaries that have not guaranteed the 2026 Senior Notes.

At any time before December 15, 2021, we may redeem all or a portion of the 2026 Senior Notes at a redemption price equal to 100% of the aggregate principal amount of the 2026 Senior Notes to be redeemed, plus a "make-whole" premium and accrued and unpaid interest to, but excluding, the redemption date. At any time on or after December 15, 2021, we may redeem all or a portion of the 2026 Senior Notes at certain redemption prices expressed as percentages of the principal amount, plus accrued and unpaid interest to, but excluding, the redemption date. At any time and from time to time before December 15, 2021, we may redeem up to 35% of the aggregate outstanding principal amount of the 2026 Senior Notes with the net cash proceeds received by us from certain equity offerings at a price equal to 105.625% of the aggregate principal amount, plus accrued and unpaid interest to, but excluding, the redemption date, provided that the redemption occurs no later than 120 days after the closing of the related equity offering, and at least 50% of the original aggregate principal amount of the 2026 Senior Notes remains outstanding immediately thereafter. Upon the occurrence of certain asset sales or a change in control, we must offer to repurchase the 2026 Senior Notes at a price equal to 100% in the case of an asset sale, or 101% in the case of a change of control, of the principal amount plus accrued and unpaid interest to, but excluding, the repurchase date.

5.375% Senior Notes due 2020

In August 2012, we issued \$700.0 million aggregate principal amount of 5.375% Senior Notes due on August 15, 2020 in a private placement. In October 2012, we issued an additional \$350.0 million aggregate principal amount of our 5.375% Senior Notes (collectively the "2020 Senior Notes"). The 2020 Senior Notes bear interest at 5.375% per year, payable in cash semi-annually in arrears. The 2020 Senior Notes are our unsecured senior obligations and are guaranteed on an unsecured senior basis by certain of our domestic subsidiaries, ("the Subsidiary Guarantors"). The 2020 Senior Notes and guarantees rank equally in right of payment with all of our and the Subsidiary Guarantors' existing and future unsecured senior debt and rank senior in right of payment to all of our and the Subsidiary Guarantors' future unsecured subordinated debt. The 2020 Senior Notes and guarantees effectively rank junior to all secured debt of our and the Subsidiary Guarantors to the extent of the value of the collateral securing such debt and to all liabilities, including trade payables, of our subsidiaries that have not guaranteed the 2020 Senior Notes.

In January 2017, we repurchased \$600.0 million in aggregate principal amount of our 2020 Senior Notes using cash and cash equivalents and the net proceeds from our 2026 Senior Notes issued in December 2016. In January 2017, we recorded an extinguishment loss of \$18.4 million. In accordance with the authoritative guidance for debt instruments, a loss on extinguishment is equal to the difference between the reacquisition price and the net carrying amount of the extinguished debt, including any unamortized debt discount or issuance costs. Following this activity, \$450.0 million in aggregate principal amount of our 2020 Senior Notes remains outstanding.

6.0% Senior Notes due 2024

In June 2016, we issued \$300.0 million aggregate principal amount of 6.0% Senior Notes due on July 1, 2024 (the "2024 Senior Notes") in a private placement. The proceeds from the 2024 Senior Notes were approximately \$297.5 million, net of issuance costs. The 2024 Senior Notes bear interest at 6.0% per year, payable in cash semi-annually in

arrears. The 2024 Senior Notes are unsecured senior obligations and are guaranteed on an unsecured senior basis by our Subsidiary Guarantors. The 2024 Senior Notes and the guarantees rank equally in right of payment with all of our and the Subsidiary Guarantors' existing and future unsecured senior debt, and rank senior in right of payment to all of our and the Subsidiary Guarantors' future unsecured subordinated debt. The 2024 Senior Notes and guarantees effectively rank junior to all our secured debt and that of the Subsidiary Guarantors to the extent of the value of the collateral securing such debt and to all liabilities, including trade payables, of our subsidiaries that have not guaranteed the 2024 Senior Notes.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

1.0% Convertible Debentures due 2035

In December 2015, we issued \$676.5 million in aggregate principal amount of 1.0% Senior Convertible Debentures due in 2035 (the “1.0% 2035 Debentures”) in a private placement. We used a portion of the proceeds to repurchase \$38.3 million in aggregate principal on our 2.75% Senior Convertible Debentures due in 2031 and to repay the aggregate principal balance of \$472.5 million on the term loan. Upon the repurchase and repayment of debts in December 2015, we recorded an extinguishment loss of \$4.9 million in other expense, net, in the accompanying consolidated statements of operations. The 1.0% 2035 Debentures bear interest at 1.0% per year, payable in cash semi-annually in arrears. The 1.0% 2035 Debentures mature on December 15, 2035, subject to the right of the holders to require us to redeem the 1.0% 2035 Debentures on December 15, 2022, 2027, or 2032. The 1.0% 2035 Debentures are general senior unsecured obligations and rank equally in right of payment with all of our existing and future unsecured, unsubordinated indebtedness and senior in right of payment to any indebtedness that is contractually subordinated to the 1.0% 2035 Debentures. The 1.0% 2035 Debentures will be effectively subordinated to indebtedness and other liabilities of our subsidiaries. The initial conversion price is approximately \$27.22 per share. At issuance, we allocated \$495.4 million to long-term debt, and \$181.1 million has been recorded as additional paid-in capital, which is being amortized to interest expense using the effective interest rate method through December 2022. As of March 31, 2017 and September 30, 2016, none of the conversion criteria were met for the 1.0% 2035 Debentures. If the conversion criteria were met, we could be required to repay all or some of the aggregate principal amount in cash prior to the maturity date.

2.75% Convertible Debentures due 2031

In October 2011, we issued \$690.0 million in aggregate principal amount of 2.75% Senior Convertible Debentures due in 2031 (the “2031 Debentures”) in a private placement. The 2031 Debentures bear interest at 2.75% per year, payable in cash semi-annually in arrears. The 2031 Debentures mature on November 1, 2031, subject to the right of the holders to require us to redeem the 2031 Debentures on November 1, 2017, 2021, and 2026. The 2031 Debentures are general senior unsecured obligations and rank equally in right of payment with all of our existing and future unsecured, unsubordinated indebtedness and senior in right of payment to any indebtedness that is contractually subordinated to the 2031 Debentures. The 2031 Debentures will be effectively subordinated to indebtedness and other liabilities of our subsidiaries. The initial conversion price is approximately \$32.30 per share. At issuance, we allocated \$533.6 million to long-term debt, and \$156.4 million has been recorded as additional paid-in capital, which is being amortized to interest expense using the effective interest rate method through November 2017.

In June 2015, we entered into separate privately negotiated agreements with certain holders of our 2031 Debentures to exchange, in a private placement, \$256.2 million in aggregate principal amount of our 2031 Debentures for approximately \$263.9 million in aggregate principal amount of our 1.5% 2035 Debentures. In December 2015, we entered into separate privately negotiated agreements with certain holders of our 2031 Debentures to repurchase \$38.3 million in aggregate principal with proceeds received from the issuance of our 1.0% 2035 Debentures. In March 2017, we entered into separate privately negotiated agreements with certain holders of our 2031 Debentures to repurchase \$17.8 million in aggregate principal with proceeds received from the issuance of our 1.25% Senior Convertible Debentures issued in March 2017. Following these activities, \$377.7 million in aggregate principal amount of our 2031 Debentures remain outstanding. As of March 31, 2017, the remaining aggregate outstanding principal balance has been classified as current portion of long-term debt on the consolidated balance sheet as the holders have the right to require us to redeem on November 1, 2017. As of March 31, 2017 and September 30, 2016, none of the conversion criteria were met for the 2031 Debentures. If the conversion criteria were met, we could be required to repay all or some of the aggregate principal amount in cash prior to the maturity date.

1.25% Convertible Debentures due 2025

In March 2017, we issued \$350.0 million in aggregate principal amount of 1.25% Senior Convertible Debentures due in 2025 (the “1.25% 2025 Debentures”) in a private placement. The proceeds were approximately \$343.6 million, net of issuance costs. We used a portion of the proceeds to repurchase 5.8 million shares of our common stock for \$99.1 million and \$17.8 million in aggregate principal on our 2031 Debentures. We intend to use the remaining net

proceeds, together with cash on hand, to repurchase, redeem, retire or otherwise repay all of our remaining outstanding 2031 Debentures in November 2017. The 1.25% 2025 Debentures bear interest at 1.25% per year, payable in cash semi-annually in arrears, beginning on October 1, 2017. The 1.25% 2025 Debentures mature on April 1, 2025. The 1.25% 2025 Debentures are general senior unsecured obligations and rank equally in right of payment with all of our existing and future unsecured, unsubordinated indebtedness and senior in right of payment to any indebtedness that is contractually subordinated to the 1.25% 2025 Debentures. The 1.25% 2025 Debentures will be effectively subordinated to indebtedness and other liabilities of our subsidiaries.

We account separately for the liability and equity components of the 1.25% 2025 Debentures in accordance with authoritative guidance for convertible debt instruments that may be settled in cash upon conversion. The guidance requires the carrying amount of the liability component to be estimated by measuring the fair value of a similar liability that does not have an associated

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

conversion feature and record the remainder in stockholders' equity. At issuance, we allocated \$252.1 million to long-term debt, and \$97.9 million has been recorded as additional paid-in capital, which is being amortized to interest expense using the effective interest rate method through April 1, 2025.

If converted, the principal amount of the 1.25% 2025 Debentures is payable in cash and any amounts payable in excess of the principal amount will (based on an initial conversion rate, which represents an initial conversion price of approximately \$22.22 per share, subject to adjustment under certain circumstances) be paid in cash or shares of our common stock, at our election, only in the following circumstances and to the following extent: (i) prior to October 1, 2024, on any date during any fiscal quarter beginning after June 30, 2017 (and only during such fiscal quarter) if the closing sale price of our common stock was more than 130% of the then current conversion price for at least 20 trading days in the period of the 30 consecutive trading days ending on the last trading day of the previous fiscal quarter; (ii) at any time on or after October 1, 2024, (iii) during the five consecutive business-day period immediately following any five consecutive trading-day period in which the trading price for \$1,000 principal amount of the 1.25% 2025 Debentures for each day during such five trading-day period was less than 98% of the closing sale price of our common stock multiplied by the then current conversion rate; or (iv) upon the occurrence of specified corporate transactions, as described in the indenture for the 1.25% 2025 Debentures. We may not redeem the 1.25% 2025 Debentures prior to the maturity date. If we undergo a fundamental change or non-stock change of control (as described in the indenture for the 1.25% 2025 Debentures) prior to maturity, holders will have the option to require us to repurchase all or any portion of their debentures for cash at a price equal to 100% of the principal amount of the 1.25% 2025 Debentures to be purchased plus any accrued and unpaid interest, including any additional interest to, but excluding, the repurchase date. As of March 31, 2017, none of the conversion criteria were met for the 1.25% 2025 Debentures. If the conversion criteria were met, we could be required to repay all or some of the aggregate principal amount in cash prior to the maturity date.

1.50% Convertible Debentures due 2035

In June 2015, we issued \$263.9 million in aggregate principal amount of 1.50% Senior Convertible Debentures due in 2035 (the "1.5% 2035 Debentures") in exchange for \$256.2 million in aggregate principal amount of our 2031 Debentures. The 1.5% 2035 Debentures were issued at 97.09% of the principal amount, which resulted in a discount of \$7.7 million. The 1.5% 2035 Debentures bear interest at 1.50% per year, payable in cash semi-annually in arrears. The 1.5% 2035 Debentures mature on November 1, 2035, subject to the right of the holders to require us to redeem the 1.5% 2035 Debentures on November 1, 2021, 2026, or 2031. The 1.5% 2035 Debentures are general senior unsecured obligations and rank equally in right of payment with all of our existing and future unsecured, unsubordinated indebtedness and senior in right of payment to any indebtedness that is contractually subordinated to the 1.5% 2035 Debentures. The 1.5% 2035 Debentures will be effectively subordinated to indebtedness and other liabilities of our subsidiaries. The initial conversion price is approximately \$23.26 per share. At issuance, we allocated \$208.6 million to long-term debt, and \$55.3 million has been recorded as additional paid-in capital, which is being amortized to interest expense using the effective interest rate method through November 2021. As of March 31, 2017 and September 30, 2016, none of the conversion criteria were met for the 1.5% 2035 Debentures. If the conversion criteria were met, we could be required to repay all or some of the aggregate principal amount in cash prior to the maturity date.

Revolving Credit Facility

In April 2016, we entered into a credit agreement that provides for a \$242.5 million revolving credit line, including letters of credit (together, the "Revolving Credit Facility"). The Revolving Credit Facility matures on April 15, 2021. As of March 31, 2017, issued letters of credit in the aggregate amount of \$4.5 million were treated as issued and outstanding when calculating the borrowing availability under the Revolving Credit Facility. As of March 31, 2017, we had \$238.0 million available for additional borrowing under the Revolving Credit Facility. Any amounts outstanding under the Revolving Credit Facility will bear interest, at either (i) LIBOR plus an applicable margin of 1.50% or 1.75%, or (ii) the alternative base rate plus an applicable margin of 0.50% or 0.75%. The Revolving Credit Facility is secured by substantially all assets of ours and our Subsidiary Guarantors. The Revolving Credit Facility

contains customary affirmative and negative covenants and conditions to borrowing, as well as customary events of default.

11. Stockholders' Equity

Share Repurchases

On April 29, 2013, our Board of Directors approved a share repurchase program for up to \$500.0 million of our outstanding shares of common stock. On April 29, 2015, our Board of Directors approved an additional \$500.0 million under our share repurchase program. In March 2017, in connection with the issuance of our 1.25% 2025 Debentures, we used a portion of the net proceeds to repurchase 5.8 million shares of our common stock for \$99.1 million under the approved program. Since the commencement of the program, we have repurchased 46.5 million shares for \$806.6 million. These shares were retired upon

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

repurchase. Approximately \$193.4 million remained available for share repurchases as of March 31, 2017 pursuant to our share repurchase program. Under the terms of the share repurchase program, we have the ability to repurchase shares from time to time through a variety of methods, which may include open market purchases, privately negotiated transactions, block trades, accelerated stock repurchase transactions, or any combination of such methods. The share repurchase program does not require us to acquire any specific number of shares and may be modified, suspended, extended or terminated by us at any time without prior notice. The timing and the amount of any purchases will be determined by management based on an evaluation of market conditions, capital allocation alternatives, and other factors.

Stock Issuances

During the quarter ended March 31, 2017, we issued 844,108 shares of our common stock valued at \$13.4 million in connection with a business acquisition, which is discussed in Note 3.

12. Net Loss Per Share

As of March 31, 2017 and 2016, diluted weighted average common shares outstanding is equal to basic weighted average common shares due to our net loss position. Common equivalent shares are excluded from the computation of diluted net loss per share if their effect is anti-dilutive. Potentially dilutive common equivalent shares aggregating to 8.2 million and 8.4 million shares for the three months ended March 31, 2017 and 2016, respectively, and 8.6 million and 9.0 million shares for the six months ended March 31, 2017 and 2016, respectively, have been excluded from the computation of diluted net loss per share because their inclusion would be anti-dilutive.

13. 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 March 31,		Six Months Ended March 31,	
	2017	2016	2017	2016
Cost of professional services and hosting	\$8,080	\$7,757	\$16,490	\$15,514
Cost of product and licensing	102	122	194	244
Cost of maintenance and support	1,010	923	1,987	1,991
Research and development	8,398	7,967	16,888	17,900
Selling and marketing	11,018	10,460	22,987	23,297
General and administrative	11,740	10,934	20,932	21,565
Total	\$40,348	\$38,163	\$79,478	\$80,511

Stock Options

The table below summarizes activity relating to stock options for the six months ended March 31, 2017:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ^(a)
Outstanding at September 30, 2016	1,965,826	\$ 15.01		
Exercised	(921,787)	\$ 13.48		
Expired	(1,359)	\$ 19.86		
Outstanding at March 31, 2017	1,042,680	\$ 16.36	0.7 years	\$1.0 million
Exercisable at March 31, 2017	1,042,671	\$ 16.36	0.7 years	\$1.0 million
Exercisable at March 31, 2016	1,976,456	\$ 14.97	1.2 years	\$7.4 million

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The aggregate intrinsic value in this table was calculated based on the positive difference, if any, between the (a) closing market price of our common stock on March 31, 2017 (\$17.31) and the exercise price of the underlying options.

The weighted-average intrinsic value of stock options exercised during the six months ended March 31, 2017 and 2016 was \$0.8 million and \$8.5 million, respectively.

Restricted Units

Restricted units are not included in issued and outstanding common stock until the shares are vested and released. The purchase price for vested restricted units is \$0.001 per share. The table below summarizes activity relating to restricted units for the six months ended March 31, 2017:

	Number of Shares Underlying Restricted Units — Contingent Awards	Number of Shares Underlying Restricted Units — Time-Based Awards
Outstanding at September 30, 2016	4,224,488	5,884,023
Granted	3,014,321	6,026,857
Earned/released	(1,748,874)	(4,399,216)
Forfeited	(444,311)	(375,212)
Outstanding at March 31, 2017	5,045,624	7,136,452
Weighted average remaining recognition period of outstanding restricted units	1.7 years	1.8 years
Unearned stock-based compensation expense of outstanding restricted units	\$66.1 million	\$77.7 million
Aggregate intrinsic value of outstanding restricted units ^(a)	\$87.3 million	\$123.6 million

The aggregate intrinsic value in this table was calculated based on the positive difference between the closing (a) market price of our common stock on March 31, 2017 (\$17.31) and the purchase price of the underlying restricted units.

A summary of weighted-average grant-date fair value for awards granted and intrinsic value of all restricted units vested during the periods noted is as follows:

	Six Months Ended March 31,	
	2017	2016
Weighted-average grant-date fair value per share	\$16.05	\$20.14
Total intrinsic value of shares vested (in millions)	\$99.5	\$132.1

Restricted Stock Awards

Restricted stock awards are included in the issued and outstanding common stock at the date of grant. The table below summarizes activity related to restricted stock awards for the six months ended March 31, 2017:

	Number of Shares Underlying Restricted Stock	Weighted Average Grant Date Fair Value
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Outstanding at September 30, 2016	—	\$ —
Granted	250,000	\$ 15.55
Outstanding at March 31, 2017	250,000	\$ 15.55
Weighted average remaining recognition period of outstanding restricted stock awards	0.5 years	
Unearned stock-based compensation expense of outstanding restricted stock awards	\$2.2 million	
Aggregate intrinsic value of outstanding restricted stock awards ^(a)	\$4.3 million	

The aggregate intrinsic value in this table was calculated based on the positive difference between the closing
^(a) market price of our common stock on March 31, 2017 (\$17.31) and the purchase price of the underlying restricted stock awards.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

No restricted stock awards vested during the six months ended March 31, 2017. The weighted-average intrinsic value of restricted stock awards vested during the six months ended March 31, 2016 was \$4.3 million.

14. Income Taxes

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

	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	2017	2016	2017	2016
Domestic	\$(41,803)	\$(33,691)	\$(89,386)	\$(62,693)
Foreign	17,136	35,890	51,144	60,594
(Loss) income before income taxes	\$(24,667)	\$2,199	\$(38,242)	\$(2,099)

The components of provision from income taxes are as follows (dollars in thousands):

	Three Months		Six Months Ended	
	Ended March 31,		March 31,	
	2017	2016	2017	2016
Domestic	\$4,822	\$5,021	\$8,981	\$9,559
Foreign	4,319	4,224	10,513	7,453
Provision for income taxes	\$9,141	\$9,245	\$19,494	\$17,012
Effective tax rate	(37.1)%	420.4%	(51.0)%	(810.5)%

The effective income tax rate was (37.1)% and 420.4% for the three months ended March 31, 2017 and 2016, respectively. The effective income tax rate was (51.0)% and (810.5)% for the six months ended March 31, 2017 and 2016, respectively. Our current effective income tax rate differs from the U.S. federal statutory rate of 35% primarily due to current period losses in the United States that require an additional valuation allowance and accordingly provide no benefit to the provision as well as an increase to indefinite lived deferred tax liabilities. This is partially offset by our earnings in foreign operations that are subject to a significantly lower tax rate than the U.S. statutory tax rate, driven primarily by our subsidiaries in Ireland.

The effective income tax rate is based upon the income for the year, the composition of the income in different countries, changes relating to valuation allowances for certain countries if and as necessary, and adjustments, if any, for the potential tax consequences, benefits or resolutions of audits or other tax contingencies. Our aggregate income tax rate in foreign jurisdictions is lower than our income tax rate in the United States. The majority of our income before provision for income taxes from foreign operations has been earned by subsidiaries in Ireland. Our effective tax rate may be adversely affected by earnings being lower than anticipated in countries where we have lower statutory tax rates and higher than anticipated in countries where we have higher statutory tax rates.

At March 31, 2017 and September 30, 2016, we had gross tax effected unrecognized tax benefits of \$28.3 million and \$27.3 million, respectively, which are included in other long-term liabilities. If these benefits were recognized, they would impact our effective tax rate. We do not expect a significant change in the amount of unrecognized tax benefits within the next 12 months.

15. Commitments and Contingencies

Litigation and Other Claims

Similar to many companies in the software industry, we are involved in a variety of claims, demands, suits, investigations and proceedings that arise from time to time relating to matters incidental to the ordinary course of our business, including actions with respect to contracts, intellectual property, employment, benefits and securities matters. We have estimated the amount of probable losses that may result from all currently pending matters, and such amounts are reflected in our consolidated financial statements. These recorded amounts are not material to our consolidated financial position or results of operations and no additional material losses related to these pending matters are reasonably possible. While it is not possible to predict the outcome of these matters with certainty, we do not expect the results of any of these actions to have a material adverse effect on our results of operations or financial

position. However, each of these matters is subject to uncertainties, the actual losses may prove to be larger or smaller than the accruals reflected in our consolidated financial statements, and we could incur judgments or enter into settlements of claims that could adversely affect our financial position, results of operations or cash flows.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Guarantees and Other

We often include indemnification provisions in the customer and business partner contracts. 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 Delaware law, which provides among other things, indemnification to 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 period. To the extent that we do not purchase a director and officer insurance policy for the full period of any contractual indemnification, and such directors and officers do not have coverage under separate insurance policies, we would be required to pay for costs incurred, if any, as described above.

16. Segment and Geographic Information

We operate in, and report financial information for, the following four reportable segments: Healthcare, Mobile, Enterprise, and Imaging. Segment profit is an important measure used for evaluating performance and for decision-making purposes and reflects the direct controllable costs of each segment together with an allocation of sales and corporate marketing expenses, and certain research and development project costs that benefit multiple product offerings. Segment profit represents income from operations excluding stock-based compensation, amortization of intangible assets, acquisition-related costs, net, restructuring and other charges, net, costs associated with intellectual property collaboration agreements, other expense, net and certain unallocated corporate expenses. We believe that these adjustments allow for more complete comparisons to the financial results of the historical operations.

The Healthcare segment is primarily engaged in clinical speech and clinical language understanding solutions that improve the clinical documentation process - from capturing the complete patient record to improving clinical documentation and quality measures for reimbursement. The Mobile segment is primarily engaged in providing a broad portfolio of specialized virtual assistants and connected services built on voice recognition, text-to-speech, natural language understanding, dialog, and text input technologies. Our Enterprise segment is primarily engaged in using speech, natural language understanding, and artificial intelligence to provide automated and assisted customer solutions and services for voice, mobile, web and messaging channels, in native and secure modes. The Imaging segment is primarily engaged in software solutions and expertise that help professionals and organizations to gain optimal control of their document and information processes through scanning and print management.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

We do not track our assets by operating segment. Consequently, it is not practical to show assets or depreciation by operating segment. The following table presents segment results along with a reconciliation of segment profit to (loss) income before income taxes (dollars in thousands):

	Three Months Ended March 31,		Six Months Ended March 31,	
	2017	2016	2017	2016
Segment revenues ^(a) :				
Healthcare	\$238,466	\$244,391	\$477,673	\$492,475
Mobile	100,226	91,835	192,010	188,238
Enterprise	119,357	94,443	232,295	183,219
Imaging	53,048	56,744	105,137	118,351
Total segment revenues	511,097	487,413	1,007,115	982,283
Less: acquisition-related revenues adjustments	(11,524)	(8,680)	(19,884)	(17,435)
Total consolidated revenues	499,573	478,733	987,231	964,848
Segment profit:				
Healthcare	83,328	78,382	161,896	159,611
Mobile	40,437	33,448	73,909	67,212
Enterprise	41,772	34,059	73,730	60,270
Imaging	18,470	22,192	36,086	49,177
Total segment profit	184,007	168,081	345,621	336,270
Corporate expenses and other, net	(30,186)	(35,878)	(61,148)	(66,598)
Acquisition-related revenues and cost of revenues adjustments	(11,524)	(8,471)	(19,884)	(17,060)
Stock-based compensation	(40,348)	(38,163)	(79,478)	(80,511)
Amortization of intangible assets	(45,130)	(42,787)	(88,531)	(85,451)
Acquisition-related costs, net	(5,379)	(1,225)	(14,405)	(3,705)
Restructuring and other charges, net	(19,911)	(6,652)	(26,614)	(14,540)
Costs associated with IP collaboration agreements	—	(2,000)	—	(4,000)
Other expense, net	(56,196)	(30,706)	(93,803)	(66,504)
(Loss) income before income taxes	\$(24,667)	\$2,199	\$(38,242)	\$(2,099)

Segment revenues differ from reported revenues due to certain revenue adjustments related to acquisitions that would otherwise have been recognized but for the purchase accounting treatment of the business combinations.

^(a) These revenues are included to allow for more complete comparisons to the financial results of historical operations and in evaluating management performance.

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

	Three Months Ended		Six Months Ended	
	March 31,	March 31,	March 31,	March 31,
	2017	2016	2017	2016
United States	\$352,937	\$338,710	\$702,107	\$694,524
International	146,636	140,023	285,124	270,324
Total revenues	\$499,573	\$478,733	\$987,231	\$964,848

Table of Contents

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 condensed consolidated financial statements.

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 Disclosures About Market Risk" under Items 2 and 3, respectively, of Part I of this report, and the sections entitled "Legal Proceedings" and "Risk Factors," under Items 1 and 1A, 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 bookings, 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 segments;

- our transformation program to reduce costs and optimize processes;

- market trends;

- technological advancements;

- the potential of future product releases;

- our product development plans and the timing, amount and impact of investments in research and development;

- future acquisitions, and anticipated benefits from acquisitions;

- international operations and localized versions of our products; and

- the conduct, timing and outcome of 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 terms, or other 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.

OVERVIEW

Business Overview

We are a leading provider of voice recognition and natural language understanding solutions. Our solutions and technologies are used in the healthcare, mobile, consumer, enterprise customer service, and imaging markets. We are seeing several trends in our markets, including (i) the growing adoption of cloud-based, connected services and highly interactive mobile applications, (ii) deeper integration of virtual assistant capabilities and services, and (iii) the continued expansion of our core technology portfolio from speech recognition to natural language understanding, semantic processing, domain-specific reasoning, dialog management capabilities, artificial intelligence, and biometric speaker authentication.

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

the Internet, telecommunications systems, electronic medical records ("EMR"), wireless and mobile networks and related corporate infrastructure to conduct business.

Healthcare. Trends in our healthcare business include growing customer preference for hosted solutions and subscription-based license models and increased use of mobile devices to access healthcare systems and create clinical

23

Table of Contents

documentation within electronic health record systems. In addition, we are experiencing growing demand for integrated solutions, combining our Dragon Medical and hosted transcription offerings. The volume processed in our hosted transcription services has continued to erode as customers adopt electronic medical record systems and our Dragon Medical solutions. This decline has been partially offset by new customer wins and the increased sale of integrated solutions of our transcription and Dragon Medical offerings. We have also experienced declines in our Dragon Medical perpetual license revenue as customers shift toward Dragon Medical cloud offerings. These cloud offerings are enabling the expansion of our Dragon Medical solutions to include new clinical language understanding and artificial intelligence innovations, providing real time queries to the physician at the point of care. We believe an important trend in the healthcare market is the desire to improve efficiency in the coding and revenue cycle management process. Our solutions reduce costs by increasing automation of this important workflow and also enable hospitals to improve documentation used to support billings. The industry's shift in international classification of diseases ("ICD") from ICD-9 to ICD-10, together with evolving reimbursement reform that is increasingly focused on clinical outcomes, has increased the complexity of the clinical documentation and coding processes. This shift is reinforcing our customers' desire for improved efficiency. We are investing to expand our product set to address the various opportunities, including deeper integration with our clinical documentation solutions; investing in our cloud-based products and operations; entering new and adjacent markets such as ambulatory care; and expanding our international capabilities.

Mobile. Trends in our mobile business include automotive original equipment manufacturers ("OEM") differentiating their offerings by using voice and content to provide an enhanced experience for drivers; consumer electronics companies and cable operators competing to develop virtual assistant technologies for the home; geographic expansion of our mobile operator services; and the adoption of our technology on a broadening scope of devices, such as televisions, set-top boxes, and third-party applications. The more powerful capabilities within automobiles and mobile devices require us to supply a broader portfolio of specialized virtual assistants and connected services providing voice recognition, content integration, text-to-speech, and natural language understanding capabilities. We continued to see increased demand for our enhanced offerings that combined speech and natural language understanding technology with artificial intelligence particularly from large automotive OEMs for our embedded and connected solutions. We are continuing to see a decline in our devices revenue resulting from the consolidation of the device market to a small number of customers as well as increased competition in voice recognition and natural language solutions and services sold to device OEMs. We continue to see demand involving the sale and delivery of both software and non-software related services, as well as products to help customers define, design and implement increasingly robust and complex custom solutions such as virtual assistants. We continue to see an increasing proportion of revenue from on-demand and transactional arrangements as opposed to traditional perpetual licensing of our Mobile products and solutions. Although this has a negative impact on near-term revenue, we believe this model will build more predictable revenues over time. We are investing in the expansion of the cloud capabilities and content of our automotive solutions; machine learning technologies, expansion across the Internet of Things in our devices solutions; and go-to market strategies with mobile operators.

Enterprise. Trends in our enterprise business include increasing interest in the use of mobile applications and web sites to access customer care systems and records, voice-based authentication of users, 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. In addition, for large enterprise businesses around the world, customer service interactions are accelerating toward more pervasive digital engagement across web, mobile and social platforms. In order to acquire and retain customers, enterprises need to be able to provide a customer service experience when and how the customer desires. This is creating a growing market opportunity for our omni-channel enterprise solutions, and with the acquisition of TouchCommerce, Inc., which closed during the fourth quarter of fiscal year 2016, we will be able to provide an end-to-end engagement platform that merges intelligent self-service with assisted service to increase customer satisfaction, strengthen customer loyalty and improve business results. In fiscal year 2016, revenues and bookings from on-demand solutions continued to increase, as a growing proportion of

customers choose our cloud-based solutions for call center, web and mobile customer care solutions. We expect these trends to continue in fiscal year 2017. We are investing to extend our technology capabilities with intelligent self-service and artificial intelligence for customer service; extend the market for our on-demand omni-channel enterprise solutions into international markets; expand our sales and solutions for voice biometrics; and expand our on-premise product and services portfolio.

Imaging. The imaging market is evolving to include more networked solutions to multi-function printing ("MFP") devices, as well as more mobile access to those networked solutions, and away from packaged software. We are investing to merge the scan and print technology platforms to improve mobile access to our solutions and technologies; expand our distribution channels and embedding relationships; and expand our language coverage for optical character recognition ("OCR") in order to drive a more comprehensive and compelling offering to our partners.

Table of Contents

Key Metrics

In evaluating the financial condition and operating performance of our business, management focuses on revenues, net income, gross margins, operating margins, cash flow from operations, and changes in deferred revenue. A summary of these key financial metrics is as follows:

For the six months ended March 31, 2017, as compared to the six months ended March 31, 2016:

- Total revenues increased by \$22.4 million to \$987.2 million;
- Net loss increased by \$38.6 million to a loss of \$57.7 million;
- Gross margins decreased by 0.5 percentage points to 56.9%;
- Operating margins decreased by 1.0 percentage points to 5.6%; and
- Cash provided by operating activities decreased \$50.7 million to \$250.3 million.

As of March 31, 2017, as compared to March 31, 2016:

• Total deferred revenue increased 7.2% from \$748.5 million to \$802.4 million driven primarily by our hosting solutions, most notably for our automotive connected services in our Mobile segment.

In addition to the above key financial metrics, we also focus on certain operating metrics. A summary of these key operating metrics for the quarter ended March 31, 2017, as compared to the quarter ended March 31, 2016, is as follows:

• Net new bookings increased 30.8% from one year ago to \$410.4 million. The net new bookings growth benefited from strong bookings performance in our Healthcare and Mobile segments.

Bookings represent the estimated gross revenue value of transactions at the time of contract execution, except for maintenance and support offerings. For fixed price contracts, the bookings value represents the gross total contract value. For contracts where revenue is based on transaction volume, the bookings value represents the contract price multiplied by the estimated future transaction volume during the contract term, whether or not such transaction volumes are guaranteed under a minimum commitment clause. Actual results could be different than our initial estimate. The maintenance and support bookings value represents the amounts the customer is invoiced in the period. Because of the inherent estimates required to determine bookings and the fact that the actual resultant revenue may differ from our initial bookings estimates, we consider bookings one indicator of potential future revenue and not as an arithmetic measure of backlog.

Net new bookings represents the estimated revenue value at the time of contract execution from new contractual arrangements or the estimated revenue value incremental to the portion of value that will be renewed under pre-existing arrangements;

Recurring revenue represented 73.3% and 69.0% of total revenue for six months ended March 31, 2017 and March 31, 2016, respectively. Recurring revenue represents the sum of recurring product and licensing, hosting, and maintenance and support revenues as well as the portion of professional services revenue delivered under ongoing contracts. Recurring product and licensing revenue comprises term-based and ratable licenses as well as revenues from royalty arrangements;

Annualized line run-rate in our on-demand healthcare solutions decreased 8% from one year ago to approximately 4.7 billion lines per year. The decrease was primarily due to continued erosion in our transcription services. The annualized line run-rate is determined using billed equivalent line counts in a given quarter, multiplied by four; and Estimated three-year value of total on-demand contracts at March 31, 2017 increased 19% from one year ago to approximately \$2.6 billion. The increase was primarily due to our Enterprise omni-channel solutions and Dragon Medical cloud offerings. We determine this value as of the end of the period reported, by using our estimate of three years of anticipated future revenue streams under signed on-demand contracts then in place, whether or not they are guaranteed through a minimum commitment clause. Our estimate is based on assumptions used in evaluating the contracts and determining sales compensation, adjusted for changes in estimated launch dates, actual volumes achieved and other factors deemed relevant. For contracts with an expiration date beyond three years, we include only the value expected within three years. For other contracts, we assume renewal consistent with historic renewal rates unless there is a known cancellation. Contracts are

Table of Contents

generally 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 revenues by product type and by geographic location, based on the location of our customers, in dollars and percentage change (dollars in millions):

	Three Months				Six Months			
	Ended		Dollar	Percent	Ended		Dollar	Percent
	March 31,	March 31,	Change	Change	March 31,	March 31,	Change	Change
	2017	2016		%	2017	2016		%
Professional services and hosting	\$258.7	\$240.2	\$ 18.5	7.7 %	\$512.1	\$467.3	\$44.8	9.6 %
Product and licensing	159.3	158.6	0.6	0.4 %	311.0	337.7	(26.7)	(7.9)%
Maintenance and support	81.6	79.9	1.7	2.1 %	164.1	159.8	4.3	2.7 %
Total Revenues	\$499.6	\$478.7	\$ 20.8	4.4 %	\$987.2	\$964.8	\$22.4	2.3 %
United States	\$352.9	\$338.7	\$ 14.2	4.2 %	\$702.1	\$694.5	\$7.6	1.1 %
International	146.6	140.0	6.6	4.7 %	285.1	270.3	14.8	5.5 %
Total Revenues	\$499.6	\$478.7	\$ 20.8	4.4 %	\$987.2	\$964.8	\$22.4	2.3 %

The geographic split for the three months ended March 31, 2017, was 71% of total revenues in the United States and 29% internationally, as compared to 71% of total revenues in the United States and 29% internationally for the same period last year.

The geographic split for the six months ended March 31, 2017, was 71% of total revenues in the United States and 29% internationally, as compared to 72% of total revenues in the United States and 28% internationally for the same period last year.

Professional Services and Hosting Revenue

Professional services revenue primarily consists of consulting, implementation and training services for customers. Hosting revenue primarily relates to delivering on-demand hosted services such as medical transcription, automated customer care applications, mobile operator services, mobile infotainment, and search and transcription, over a specified term. The following table shows professional services and hosting revenue, in dollars and as a percentage of total revenues (dollars in millions):

	Three Months				Six Months Ended			
	Ended		Dollar	Percent	Ended		Dollar	Percent
	March 31,	March 31,	Change	Change	March 31,	March 31,	Change	Change
	2017	2016		%	2017	2016		%
Professional services revenue	\$56.5	\$55.6	\$ 1.0	1.7 %	\$116.7	\$105.2	\$ 11.4	10.9 %
Hosting revenue	202.2	184.6	17.5	9.5 %	395.4	362.1	33.4	9.2 %
Professional services and hosting revenue	\$258.7	\$240.2	\$ 18.5	7.7 %	\$512.1	\$467.3	\$ 44.8	9.6 %
As a percentage of total revenue	51.8 %	50.2 %			51.9 %	48.4 %		

Three Months Ended March 31, 2017 compared with Three Months Ended March 31, 2016

In our hosting business, Enterprise hosting revenue increased \$9.0 million primarily driven by strength across many of our omni-channel cloud offerings including revenue from a recent acquisition. Mobile on-demand revenue grew \$6.9 million primarily driven by a continued trend toward cloud-based services in our automotive solutions and strength in our mobile operator services. Healthcare on-demand revenue grew \$1.6 million with strong growth in our Dragon Medical cloud revenue as we continue to transition to cloud offerings partially offset by a revenue decrease due to continued erosion in our transcription services.

Six Months Ended March 31, 2017 compared with Six Months Ended March 31, 2016

In our hosting business, Enterprise hosting revenue increased \$24.6 million primarily driven by revenue from a recent acquisition and strength across many of our omni-channel cloud offerings. Mobile on-demand revenue grew \$11.0 million primarily driven by a continued trend toward cloud-based services in our automotive solutions and strength in our mobile operator services. These increases were partially offset by a \$2.3 million decrease in the Healthcare

hosting revenue as we continue to experience some erosion in our transcription services which is partially offset by growth in our Dragon Medical cloud revenue due to transition to cloud offerings. In our professional services business, Healthcare professional services revenue increased \$7.2 million driven

Table of Contents

by an acquisition in fiscal year 2016. In addition, professional services revenue increased \$3.1 million in our Mobile segment and \$1.1 million in our Enterprise segment.

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 revenues (dollars in millions):

	Three Months Ended		Dollar Change	Percent Change	Six Months Ended		Dollar Change	Percent Change
	March 31, 2017	March 31, 2016			March 31, 2017	March 31, 2016		
Product and licensing revenue	\$159.3	\$158.6	\$ 0.6	0.4 %	\$311.0	\$337.7	\$(26.7)	(7.9)%
As a percentage of total revenue	31.9 %	33.1 %			31.5 %	35.0 %		

Three Months Ended March 31, 2017 compared with Three Months Ended March 31, 2016

The increase in product and licensing revenue consisted of a \$6.7 million increase in our Enterprise segment and a \$1.4 million increase in our Mobile segment driven by growth in our embedded speech license sales. These increases were partially offset by a \$4.4 million decrease in our Healthcare segment as we continue to transition our Dragon Medical offerings from a perpetual license sales model to a cloud service model and a \$3.1 million decrease in our Imaging license sales.

Six Months Ended March 31, 2017 compared with Six Months Ended March 31, 2016

The decrease in product and licensing revenue consisted of a \$18.1 million decrease in our Healthcare segment, a \$8.3 million decrease in our Mobile segment, and an \$11.1 million decrease in our Imaging segment, partially offset by a \$10.7 million increase in our Enterprise segment. The revenue decrease in our Healthcare segment was mainly driven by lower revenues from our Dragon Medical perpetual license sales as we transition from perpetual to cloud and subscription models. The revenue decrease in our Mobile business was driven by a decline in devices revenue resulting from deterioration in mature markets, partially offset by revenue growth in our automotive business. The revenue decrease in our Imaging segment was mainly driven by lower sales of our MFP products. These decreases were partially offset with higher license sales within our Enterprise segment.

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 revenues (dollars in millions):

	Three Months Ended		Dollar Change	Percent Change	Six Months Ended		Dollar Change	Percent Change
	March 31, 2017	March 31, 2016			March 31, 2017	March 31, 2016		
Maintenance and support revenue	\$81.6	\$79.9	\$ 1.7	2.1 %	\$164.1	\$159.8	\$ 4.3	2.7 %
As a percentage of total revenue	16.3 %	16.7 %			16.6 %	16.6 %		

Three Months Ended March 31, 2017 compared with Three Months Ended March 31, 2016

The increase in maintenance and support revenue was driven primarily by our Enterprise and Imaging segments.

Six Months Ended March 31, 2017 compared with Six Months Ended March 31, 2016

The increase in maintenance and support revenue was driven primarily by our Enterprise and Imaging segments.

Table of Contents

Costs and Expenses

Cost of Professional Services and Hosting Revenue

Cost of professional services and hosting revenue primarily consists of compensation for services personnel, outside consultants and overhead, as well as the hardware, infrastructure and communications fees that support our hosting solutions. The following table shows the 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		Dollar Change		Percent Change		Six Months Ended		Dollar Change		Percent Change	
	March 31, 2017	March 31, 2016					March 31, 2017	March 31, 2016				
Cost of professional services and hosting revenue	\$164.2	\$154.7	\$ 9.5	6.1 %	\$329.1	\$308.0	\$ 21.1	6.8 %				
As a percentage of professional services and hosting revenue	63.5 %	64.4 %			64.3 %	65.9 %						

Three Months Ended March 31, 2017 compared with Three Months Ended March 31, 2016

The increase in cost of professional services and hosting revenue was primarily driven by higher compensation expense in our Enterprise segment driven by recent acquisitions and higher cloud services costs driven by growth in our Dragon Medical cloud revenue in our Healthcare segment. Gross margins increased 0.9 percentage points primarily driven by margin expansion in our cloud-based services within our Mobile and Healthcare segments, partially offset by impact from a recent acquisition which carries a lower gross margin.

Six Months Ended March 31, 2017 compared with Six Months Ended March 31, 2016

The increase in cost of professional services and hosting revenue was primarily driven by higher compensation expense in our Enterprise segment driven by recent acquisitions. Gross margins increased 1.6 percentage points primarily driven by margin expansion in our cloud-based services within our Mobile segment, partially offset by impact from a recent acquisition which carries a lower gross margin.

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 the cost of product and licensing revenue, in dollars and as a percentage of product and licensing revenue (dollars in millions):