

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**Form 10-K**

(Mark One)

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

For the fiscal year ended September 30, 2011

OR

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

For the transition period from to

Commission file number 0-27038

**NUANCE COMMUNICATIONS, INC.**

*(Exact name of Registrant as Specified in its Charter)*

**Delaware**

*(State or Other Jurisdiction of  
Incorporation or Organization)*

**94-3156479**

*(I.R.S. Employer  
Identification No.)*

**1 Wayside Road**

**Burlington, Massachusetts**

*(Address of Principal Executive Offices)*

**01803**

*(Zip Code)*

**Registrant's telephone number, including area code:**

**(781) 565-5000**

**SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:**

Title of Each Class

Name of Each Exchange on Which Registered

Common stock, \$0.001 par value

NASDAQ Stock Market LLC

**SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:**

None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

The aggregate market value of the outstanding common equity held by non-affiliates of the Registrant as of the last business day of the Registrant's most recently completed second fiscal quarter was approximately \$3.6 billion based upon the last reported sales price on the Nasdaq National Market for such date. For purposes of this disclosure, shares of Common Stock held by officers and directors of the Registrant and by persons who hold more than 5% of the outstanding Common Stock have been excluded because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily conclusive.

The number of shares of the Registrant's Common Stock, outstanding as of October 31, 2011, was 300,761,764.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's definitive Proxy Statement to be delivered to stockholders in connection with the Registrant's 2011 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

NUANCE COMMUNICATIONS, INC.

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## PART I

This Annual Report on Form 10-K 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. All statements other than statements of historical fact are statements that could be deemed forward-looking, including statements pertaining to: our future revenue, cost of revenue, research and development expense, selling, general and administrative expenses, amortization of intangible assets and gross margin, earnings, cash flows and liquidity; our strategy relating to our segments; the potential of future product releases; our product development plans and investments in research and development; future acquisitions and anticipated benefits from acquisitions; international operations and localized versions of our products; our contractual commitments; our fiscal 2012 revenue and expense expectations and legal proceedings and litigation matters. You can identify these and other forward-looking statements by the use of words such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “intends,” “potential,” “continue” or the negative of such 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 as a result of various factors, including those set forth in Item 1A of this Annual Report under the heading “Risk Factors.” All forward-looking statements included in this document are based on information available to us on the date hereof. We will not undertake and specifically decline any obligation to update any forward-looking statements.

### Item 1. *Business*

#### Overview

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

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

We have built a world-class portfolio of intellectual property, technologies, applications and solutions through both internal development and acquisitions. We expect to continue to pursue opportunities to expand our assets, geographic presence, distribution network and customer base through acquisitions of other businesses and technologies.

Effective in the fourth quarter of fiscal 2011, we are organized in four segments; Healthcare, Mobile and Consumer, Enterprise, and Imaging. In fiscal 2011, segment revenue as a percentage of total segment revenue for Healthcare, Mobile and Consumer, Enterprise and Imaging was 38%, 28%, 21% and 13%, respectively. In fiscal 2010, segment revenue as a percentage of total segment revenue for Healthcare, Mobile and Consumer, Enterprise and Imaging was 38%, 26%, 25% and 12%, respectively. See Note 22 to the consolidated financial statements for additional information about our reportable segments.

#### Healthcare

The healthcare industry is under significant pressure to streamline operations, reduce costs and improve patient care. In recent years, healthcare organizations such as hospitals, clinics, medical groups, physicians' offices and

insurance providers have increasingly turned to speech recognition solutions to automate manual processes such as the dictation and transcription of patient records.

We provide comprehensive dictation and transcription solutions and services that automate the input and management of medical information. Our hosted and on-premise solutions provide platforms to generate and distribute clinical documentation through the use of advanced dictation and transcription features, and allow us to deliver scalable, highly productive medical transcription solutions. Our solutions also enable us to accelerate future innovation to transform the way healthcare providers document patient care, through improved interface with electronic medical records and extraction of clinical information to support the billing and insurance reimbursement processes. We also offer speech recognition solutions for radiology, cardiology, pathology and related specialties, that help healthcare providers dictate, edit and sign reports without manual transcription.

We utilize a focused, enterprise sales team and professional services organization to address the market and implementation requirements of the healthcare industry. Direct distribution is supplemented by distributors and partnerships with electronic medical records application and other healthcare IT providers such as 3M, Allscripts, Cerner, Epic, GE, IBM and McKesson. In some cases, our healthcare solutions are priced under a traditional software perpetual licensing model. However, certain of our healthcare solutions, in particular our transcription solution, are also offered on an on-demand model, charged as a subscription and priced by volume of usage (such as number of lines transcribed). During fiscal 2009, 2010 and 2011, we experienced a significant shift in customer preference toward our subscription pricing model. Representative customers include Banner Health, Cleveland Clinic, Department of Veterans Affairs, HCA, Kaiser Permanente, Mayo Clinic, NHS, Sutter Health, Tenet, UPMC and U.S. Army.

### **Mobile and Consumer**

Today, an increasing number of people worldwide rely on mobile devices to stay connected, informed and productive. We help consumers use the powerful capabilities of their phones, cars, tablets, desktop and portable computers, personal navigation devices and other consumer electronics by enabling the use of voice commands, text-to-speech and enhanced text input solutions to control and interact with these devices more easily and naturally, and to access the array of content and services available on the Internet.

Our portfolio of mobile and consumer solutions and services includes an integrated suite of voice control and text-to-speech solutions, dictation applications, predictive text technologies, mobile messaging services and emerging services such as dictation, Web search and voicemail-to-text. Our suite of Dragon general purpose desktop and portable computer dictation applications increases productivity by using speech to create documents, streamline repetitive and complex tasks, input data, complete forms and automate manual transcription processes. In particular, we have focused in recent quarters on integrating our Dragon technology and brand initiatives across mobile and consumer markets. We utilize a focused, enterprise sales team and professional services organization to address market and implementation requirements. Direct distribution is supplemented by partnerships with electronics suppliers and integrators such as Harman Kardon and Clarion. Our solutions are used by mobile phone, automotive, personal navigation device, computer and other consumer electronic manufacturers and their suppliers, including Amazon, Apple, Audi, BMW, Ford, Garmin, GM, HTC, LG Electronics, Mercedes Benz, Nokia, Samsung, T-Mobile, TomTom and Toyota. Telecommunications carriers, web search companies and content providers are increasingly using our mobile search and communication solutions to offer value-added services to their subscribers and customers. Our embedded mobile solutions are sold to automobile and device manufacturers, generally on a royalty model priced per device sold, and sometimes on a license model. Our connected mobile services are sold through telecommunications carriers, voicemail system providers, smartphone application developers or directly to consumers, and generally priced on a volume of usage model (such as per subscriber or per use). Representative connected services customers and partners include AT&T, Cisco, Comcast, Rogers, Telefonica, Telstra, Time Warner Cable, TISA, T-Mobile and Vodafone. In addition, various smartphone app stores include hundreds of applications that utilize our technology, such as our DragonDictation, DragonGo! and FlexT9, as well as third party applications including Amazon Price Check, Ask, Bon' App, iTranslate, Merriam-Webster, Vocre and Yellow Pages.

Our desktop and portable computer dictation software is currently available in seventeen languages. During the fourth quarter of fiscal 2010, we shipped new versions of Dragon NaturallySpeaking for Windows and Dragon Dictate for Mac. Our desktop and portable computer dictation solutions are generally sold under a traditional perpetual software license model. We utilize a combination of our global reseller network and direct sales to distribute our desktop and portable computer dictation products. Resellers include retailers such as Amazon, Best Buy and WalMart. Enterprise customers include organizations such as law firms, insurance agencies and government agencies. Representative customers include ATF, Exxon, FBI, IBM, Texas Department of Family Protective Services and Zurich.

## **Enterprise**

To remain competitive, organizations must improve the quality of customer care while reducing costs and ensuring a positive customer experience. Technological innovation, competitive pressures and rapid commoditization have made it increasingly important for organizations to achieve enduring market differentiation and secure customer loyalty. In this environment, organizations need to satisfy the expectations of increasingly savvy and mobile consumers who demand high levels of customer service.

We deliver a portfolio of customer service business intelligence and authentication solutions that are designed to help companies better support, understand and communicate with their customers. Our solutions include the use of technologies such as speech recognition, natural language understanding, text-to-speech, biometric voice recognition and analytics to automate caller identification and authorization, call steering, completion of tasks such as updates, purchases and information retrieval, and automated outbound notifications. Our solutions improve the customer experience, increase the use of self-service and enable new revenue opportunities. We complement our solutions and products with a global professional services organization that supports customers and partners with business and systems consulting project management, user-interface design, voice science, application development and business performance optimization, allowing us to deliver end-to-end speech solutions and system integration for voice-enabled customer care. In addition, we offer solutions that can meet customer care needs through direct interaction with thin-client applications on cell phones, enabling customers to very quickly retrieve relevant information. Use of our speech-enabled and thin-client customer care solutions can dramatically decrease customer care costs, in comparison to calls handled by operators.

Our solutions are used by a wide variety of enterprises in customer-service intensive sectors, including telecommunications, financial services, travel and entertainment, and government. Our speech solutions are designed to serve our global partners and customers and are available in approximately 60 languages and dialects worldwide. In addition to our own sales and professional services teams, we often work closely with industry partners, including Avaya, Cisco and Genesys, that integrate our solutions into their hardware and software platforms. Our enterprise solutions offerings include both a traditional software perpetual licensing model and an on-demand model, charged as a subscription and priced by volume of usage (such as number of minutes callers use the system or number of calls completed in the system). Representative customers include Bank of America, Cigna, Citibank, Disney, FedEx, Onstar, US Airways and Wells Fargo.

## **Imaging**

The evolution of the Internet, email and other networks has greatly simplified the ability to share electronic documents, resulting in an ever-growing volume of documents to be used and stored. In addition, the proliferation of network and Internet connected multifunction printers has increased the need to efficiently manage printers and enforce printing policies. Our document imaging, print management and PDF solutions reduce the costs associated with paper documents through easy to use scanning, document management and electronic document routing solutions. We offer versions of our products to multifunction printer manufacturers, home offices, small businesses and enterprise customers.

Our imaging solutions offer optical character recognition technology to deliver highly accurate document scanning and storage. We provide networked print management and comprehensive PDF applications designed specifically for business users. In addition, we offer applications that combine network scanning, network print management and PDF creation to quickly enable distribution of documents to users' desktops or to enterprise applications. Our host of services includes software development toolkits for independent software vendors. Our

imaging solutions are generally sold under a traditional perpetual software license model, and some solutions are also offered as a hosted solution. We utilize a combination of our global reseller network and direct sales to distribute our imaging products. We license our software to multifunction printer manufacturers such as Brother, Canon, Dell, HP and Xerox, which bundle our solutions with multi-function devices, digital copiers, printers and scanners, on a royalty model, priced per unit sold.

### **Research and Development/Intellectual Property**

In recent years, we have developed and acquired extensive technology assets, intellectual property and industry expertise in voice, language and imaging that provide us with a competitive advantage in our markets. Our technologies are based on complex algorithms which require extensive amounts of linguistic and image data, acoustic models and recognition techniques. A significant investment in capital and time would be necessary to replicate our current capabilities.

We continue to invest in technologies to maintain our market-leading position and to develop new applications. Our technologies are covered by approximately 2,300 patents and 1,500 patent applications. Our intellectual property, whether purchased or developed internally, is critical to our success and competitive position and, ultimately, to our market value. We rely on a portfolio of patents, copyrights, trademarks, services marks, trade secrets, confidentiality provisions and licensing arrangements to establish and protect our intellectual property and proprietary rights. We incurred research and development expenses of \$179.4 million, \$152.1 million, and \$116.8 million in fiscal 2011, 2010 and 2009, respectively.

### **International Operations**

We have principal offices in a number of international locations including: Australia, Belgium, Canada, Germany, Hungary, India, Italy, Japan, and the United Kingdom. The responsibilities of our international operations include research and development, healthcare transcription and editing, customer support, sales and marketing and administration. Additionally, we maintain smaller sales, services and support offices throughout the world to support our international customers and to expand international revenue opportunities.

Geographic revenue classification is based on the geographic areas in which our customers are located. For fiscal 2011, 2010 and 2009, 73%, 72% and 74% of revenue was generated in the United States and 27%, 28% and 26% of revenue was generated by our international operations, respectively.

### **Competition**

The individual markets in which we compete are highly competitive and are subject to rapid technology changes. There are a number of companies that develop or may develop products that compete in our target markets; however, currently there is no one company that competes with us in all of our product areas. While we expect competition to continue to increase both from existing competitors and new market entrants, we believe that we will compete effectively based on many factors, including:

- *Specialized Professional Services.* Our superior technology, when coupled with the high quality and domain knowledge of our professional services organization, allows our customers and partners to place a high degree of confidence and trust in our ability to deliver results. We support our customers in designing and building powerful innovative applications that specifically address their needs and requirements.
- *International Appeal.* The international reach of our products is due to the broad language coverage of our offerings, including our voice and language technology, which provides recognition for approximately 60 languages and dialects and natural-sounding synthesized speech in 39 languages, and supports a broad range of hardware platforms and operating systems. Our imaging technology supports more than 100 languages.
- *Technological Superiority.* Our voice, language and imaging technologies, applications and solutions are often recognized as the most innovative and proficient products in their respective categories. Our voice and language technology has industry-leading recognition accuracy and provides a natural, voice-enabled interaction with systems, devices and applications. Our imaging technology is viewed as the most accurate in

the industry. Technology publications, analyst research and independent benchmarks have consistently indicated that our products rank at or above performance levels of alternative solutions.

- *Broad Distribution Channels.* Our ability to address the needs of specific markets, such as financial, legal, healthcare and government, and to introduce new products and solutions quickly and effectively is enhanced through our dedicated direct sales force; our extensive global network of resellers, comprising system integrators, independent software vendors, value-added resellers, hardware vendors, telecommunications carriers and distributors; and our e-commerce website ([www.nuance.com](http://www.nuance.com)).

In our segments, we compete with companies such as Adobe, Medquist, Microsoft and Google. In addition, a number of smaller companies in both speech and imaging offer services, technologies or products that are competitive with our solutions in some markets. In certain markets, some of our partners such as Avaya, Cisco, Intertec and Genesys develop and market products and services that might be considered substitutes for our solutions. Current and potential competitors have established, or may establish, cooperative relationships among themselves or with third parties to increase the ability of their technologies to address the needs of our prospective customers.

Some of our competitors or potential competitors, such as Adobe, Microsoft and Google, have significantly greater financial, technical and marketing resources than we do. These competitors may be able to respond more rapidly than we can to new or emerging technologies or changes in customer requirements. They may also devote greater resources to the development, promotion and sale of their products than we do.

### **Employees**

As of September 30, 2011, we had approximately 7,300 full-time employees in total, including approximately 900 in sales and marketing, approximately 1,750 in professional services, approximately 1,200 in research and development, approximately 550 in general and administrative and approximately 2,900 that provide transcription and editing services. Approximately 43 percent of our employees are based outside of the United States, the majority of whom provide transcription and editing services and are based in India. Our employees are not represented by any labor union and are not organized under a collective bargaining agreement, and we have never experienced a work stoppage. We believe that our relationships with our employees are generally good.

### **Company Information**

We were incorporated in 1992 as Visioneer, Inc. under the laws of the state of Delaware. In 1999, we changed our name to ScanSoft, Inc. and also changed our ticker symbol to SSFT. In October 2005, we changed our name to Nuance Communications, Inc. and in November 2005 we changed our ticker symbol to NUAN.

Our website is located at [www.nuance.com](http://www.nuance.com). This Annual Report on Form 10-K, our Quarterly Reports on Form 10-Q, our Current Reports on Form 8-K, and all amendments to these reports, as well as proxy statements and other information we file with or furnish to the Securities and Exchange Commission, or the SEC, are accessible free of charge on our website. We make these documents available as soon as reasonably practicable after we file them with, or furnish them to, the SEC. Our SEC filings are also available on the SEC's website at <http://www.sec.gov>. Alternatively, you may access any document we have filed by visiting the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. Except as otherwise stated in these documents, the information contained on our website or available by hyperlink from our website is not incorporated by reference into this report or any other documents we file with or furnish to the SEC.

### **Item 1A. Risk Factors**

You should carefully consider the risks described below when evaluating our company and when deciding whether to invest in our company. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we do not currently believe are important to an investor may also harm our business operations. If any of the events, contingencies, circumstances or conditions described in the following risks actually occurs, our business, financial condition or our results of operations could

be seriously harmed. If that happens, the trading price of our common stock could decline and you may lose part or all of the value of any of our shares held by you.

### **Risks Related to Our Business**

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

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

- slowing sales by our distribution and fulfillment partners to their customers, which may place pressure on these partners to reduce purchases of our products;
- volume, timing and fulfillment of customer orders;
- our ability to generate additional revenue from our intellectual property portfolio;
- customers delaying their purchasing decisions in anticipation of new versions of our products;
- customers delaying, canceling or limiting their purchases as a result of the threat or results of terrorism;
- introduction of new products by us or our competitors;
- seasonality in purchasing patterns of our customers;
- reduction in the prices of our products in response to competition, market conditions or contractual obligations;
- returns and allowance charges in excess of accrued amounts;
- timing of significant marketing and sales promotions;
- impairment charges against goodwill and intangible assets;
- delayed realization of synergies resulting from our acquisitions;
- write-offs of excess or obsolete inventory and accounts receivable that are not collectible;
- increased expenditures incurred pursuing new product or market opportunities;
- general economic trends as they affect retail and corporate sales; and
- higher than anticipated costs related to fixed-price contracts with our customers.

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

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

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



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

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

- difficulty in transitioning and integrating the operations and personnel of the acquired businesses;
- potential disruption of our ongoing business and distraction of management;
- potential difficulty in successfully implementing, upgrading and deploying in a timely and effective manner new operational information systems and upgrades of our finance, accounting and product distribution systems;
- difficulty in incorporating acquired technology and rights into our products and technology;
- potential difficulties in completing projects associated with in-process research and development;
- unanticipated expenses and delays in completing acquired development projects and technology integration;
- management of geographically remote business units both in the United States and internationally;
- impairment of relationships with partners and customers;
- assumption of unknown material liabilities of acquired companies;
- accurate projection of revenue plans of the acquired entity in the due diligence process;
- customers delaying purchases of our products pending resolution of product integration between our existing and our newly acquired products;
- entering markets or types of businesses in which we have limited experience; and
- potential loss of key employees of the acquired business.

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

***Charges to earnings as a result of our acquisitions may adversely affect our operating results in the foreseeable future, which could have a material and adverse effect on the market value of our common stock.***

Under accounting principles generally accepted in the United States of America, we record the market value of our common stock or other form of consideration issued in connection with an acquisition as the cost of acquiring the company or business. We have allocated that cost to the individual assets acquired and liabilities assumed, including various identifiable intangible assets such as acquired technology, acquired trade names and acquired customer relationships based on their respective fair values. Our estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain. After we complete an acquisition, the following factors could result in material charges and adversely affect our operating results and may adversely affect our cash flows:

- costs incurred to combine the operations of businesses we acquire, such as transitional employee expenses and employee retention, redeployment or relocation expenses;
- impairment of goodwill or intangible assets;
- amortization of intangible assets acquired;
- a reduction in the useful lives of intangible asset acquired;

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- identification of or changes to assumed contingent liabilities, both income tax and non-income tax related after our final determination of the amounts for these contingencies or the conclusion of the measurement period (generally up to one year from the acquisition date), whichever comes first;
- charges to our operating results to eliminate certain duplicative pre-merger activities, to restructure our operations or to reduce our cost structure;
- charges to our operating results resulting from expenses incurred to effect the acquisition; and
- charges to our operating results due to the expensing of certain stock awards assumed in an acquisition.

Intangible assets are generally amortized over a five to fifteen year period. Goodwill and certain intangible assets with indefinite lives, are not subject to amortization but are subject to an impairment analysis, at least annually, which may result in an impairment charge if the carrying value exceeds its implied fair value. As of September 30, 2011, we had identified intangible assets of approximately \$731.6 million, net of accumulated amortization, and goodwill of approximately \$2.3 billion. In addition, purchase accounting limits our ability to recognize certain revenue that otherwise would have been recognized by the acquired company as an independent business. As a result, the combined company may delay revenue recognition or recognize less revenue than we and the acquired company would have recognized as independent companies.

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

We have a significant amount of debt. As of September 30, 2011, we had a total of \$887.4 million of gross debt outstanding, including \$145.0 million in term loans due in March 2013, \$492.0 million in term loans due in March 2016 under an amended and restated agreement signed in July 2011, and \$250.0 million in convertible debentures. Investors may require us to redeem the convertible debentures in August 2014, or sooner if our common stock price exceeds the conversion price of approximately \$23.36 for certain specified periods. We also have a \$75.0 million revolving credit line available to us through March 2015. As of September 30, 2011, there were \$15.4 million of letters of credit issued but there were no other outstanding borrowings under the revolving credit line. Additionally, on October 24, 2011, we sold \$690.0 million of 2.75% convertible debentures which investors may require us to redeem in November 2017. Our debt level could have important consequences, for example it could:

- require us to use a large portion of our cash flow to pay principal and interest on debt, including the convertible debentures and the credit facility, which will reduce the availability of our cash flow to fund working capital, capital expenditures, acquisitions, research and development expenditures and other business activities;
- restrict us from making strategic acquisitions or exploiting business opportunities;
- place us at a competitive disadvantage compared to our competitors that have less debt; and
- limit, along with the financial and other restrictive covenants related to our debt, our ability to borrow additional funds, dispose of assets or pay cash dividends.

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

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

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

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

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

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

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

We reported net income of \$38.2 million in fiscal 2011, however we reported net losses of \$19.1 million and \$19.4 million for the fiscal years 2010 and 2009, respectively. If we are unable to maintain profitability, the market price for our stock may decline, perhaps substantially. We cannot assure you that our revenue will grow or that we will maintain profitability in the future. If we do not achieve and maintain profitability, we may be required to raise additional capital to maintain or grow our operations. Additional capital, if available at all, may be highly dilutive to existing investors or contain other unfavorable terms, such as a high interest rate and restrictive covenants.

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

We have invested and expect to continue to invest heavily in the acquisition, development and marketing of voice and language technologies. The market for voice and language technologies is relatively new and rapidly evolving. Our ability to increase revenue in the future depends in large measure on the continuing acceptance of these technologies in general and our products in particular. The continued development of the market for our current and future voice and language solutions in general, and our solutions in particular, will also depend on:

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

Sales of our voice and language products would be harmed if the market for these technologies does not continue to increase or increases slower than we expect, or if we fail to develop new technology faster than our competitors, and consequently, our business could be harmed and we may not achieve a level of profitability necessary to successfully operate our business.

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

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

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

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

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

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

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

Because we operate worldwide, our business is subject to risks associated with doing business internationally. We anticipate that revenue from international operations could increase in the future. Most of our international revenue is generated by sales in Europe and Asia. In addition, some of our products are developed and manufactured outside the United States and we have a large number of employees in India that provide transcription services. We also have a large number of employees in Canada and United Kingdom that provide professional services. A significant portion of the development and manufacturing of our voice and language products is conducted in

Belgium and Canada, and a significant portion of our imaging research and development is conducted in Hungary. We also have significant research and development resources in Austria, Germany, Italy, and United Kingdom. Accordingly, our future results could be harmed by a variety of factors associated with international sales and operations, including:

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

***We are exposed to fluctuations in foreign currency exchange rates.***

Because we have international subsidiaries and distributors that operate and sell our products outside the United States, we are exposed to the risk of changes in foreign currency exchange rates. In certain circumstances, we have entered into forward exchange contracts to hedge against foreign currency fluctuations. We use these contracts to reduce our risk associated with exchange rate movements, as the gains or losses on these contracts are intended to offset any exchange rate losses or gains on the hedged transaction. We do not engage in foreign currency speculation. With our increased international presence in a number of geographic locations and with international revenue and costs projected to increase, we are exposed to changes in foreign currencies including the euro, British pound, Canadian dollar, Japanese yen, Indian rupee, Australian dollar, Israel shekel, Swiss franc and the Hungarian forint. Changes in the value of foreign currencies relative to the value of the U.S. dollar could adversely affect future revenue and operating results.

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

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

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

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

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

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

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

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

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

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

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

- state and federal privacy and confidentiality laws;
- our contracts with customers and partners;
- state laws regulating healthcare professionals;
- Medicaid laws; and
- the Health Insurance Portability and Accountability Act of 1996 and related rules proposed by the Health Care Financing Administration.

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

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

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

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

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

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

- the demand for, and prices of, our products, licenses, or services are reduced as a result of actions by our competitors or otherwise; or
- our financial counterparties or other contractual counterparties are unable to, or do not, meet their contractual commitments to us.

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

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

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

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

**Risks Related to Our Intellectual Property and Technology**

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

Our success and competitive position depend in large part on our ability to obtain and maintain intellectual property rights protecting our products and services. We rely on a combination of patents, copyrights, trademarks,

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

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

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

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

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

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

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



## **Risks Related to our Corporate Structure, Organization and Common Stock**

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

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

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

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

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

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

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

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

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

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

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

**Item 1B. *Unresolved Staff Comments***

None.

**Item 2. Properties**

Our corporate headquarters and administrative, sales, marketing, research and development and customer support functions occupy approximately 201,000 square feet of space that we lease in Burlington, Massachusetts. We also lease additional properties in the United States and a number of foreign countries. The following table summarizes our significant properties as of September 30, 2011:

| <u>Location</u>             | <u>Sq. Ft.</u><br><u>(approx.)</u> | <u>Lease Term</u> | <u>Primary Use</u>  |
|-----------------------------|------------------------------------|-------------------|---|
| Burlington, Massachusetts   | 201,000                            | March 2018        | Corporate headquarters and administrative, sales, marketing, research and development and customer support functions. |
| Redwood City, California(1) | 141,000                            | July 2012         | Twelve percent of this facility is unoccupied, the remainder has been sublet to third party tenants.                  |
| Melbourne, Florida          | 130,000                            | Owned             | Administrative, professional services, and customer support.  |
| Montreal, Quebec            | 74,000                             | December 2016     | Administrative, sales, marketing, research and development, professional services, customer support functions.        |
| Sunnyvale, California       | 71,000                             | September 2013    | Administrative, research and development, professional services and customer support functions.                       |
| Seattle Washington          | 46,000                             | January 2021      | Research and development, and professional services functions.  |
| Mahwah, New Jersey          | 38,000                             | June 2015         | Professional services.  |
| New York, New York(2)       | 34,000                             | February 2016     | Subleased to third-party tenants.   |
| Merelbeke, Belgium          | 25,000                             | March 2017        | Administrative, sales, marketing, research and development and customer support functions.                            |
| Budapest, Hungary           | 31,000                             | December 2012     | Administrative and research and development.  |
| Aachen, Germany             | 22,000                             | March 2016        | Research and development and sales functions.   |

- (1) The lease for this property was assumed as part of our acquisition in September 2005 of Nuance Communications, Inc, which we refer to as Former Nuance.
- (2) The lease for this property was assumed as part of our acquisition of SpeechWorks International, Inc. in August 2003.

In addition to the properties referenced above, we also lease a number of small sales and marketing offices in the United States and internationally. As of September 30, 2011, we were productively utilizing substantially all of the space in our facilities, except for space identified above as unoccupied, or that has been subleased to third parties.

**Item 3. Legal Proceedings**

Like many companies in the software industry, we have from time to time been notified of claims that we may be infringing certain intellectual property rights of others. These claims have been referred to counsel, and they are in various stages of evaluation and negotiation. If it appears necessary or desirable, we may seek licenses for these intellectual property rights. There is no assurance that licenses will be offered by all claimants, that the terms of any

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offered licenses will be acceptable to us or that in all cases the dispute will be resolved without litigation, which may be time consuming and expensive, and may result in injunctive relief or the payment of damages by us.

**Item 4.** *[Removed and Reserved]*

**PART II****Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities****Market Information**

Our common stock is traded on the NASDAQ Global Select Market under the symbol "NUAN". The following table sets forth, for our fiscal quarters indicated, the high and low sales prices of our common stock, in each case as reported on the NASDAQ Global Select Market.

|                     | <u>Low</u> | <u>High</u> |
|---------------------|------------|-------------|
| <b>Fiscal 2010:</b> |            |             |
| First quarter       | \$ 13.11   | \$ 16.31    |
| Second quarter      | 14.12      | 17.41       |
| Third quarter       | 14.85      | 18.55       |
| Fourth quarter      | 14.45      | 17.68       |
| <b>Fiscal 2011:</b> |            |             |
| First quarter       | \$ 14.79   | \$ 19.19    |
| Second quarter      | 16.79      | 20.97       |
| Third quarter       | 18.85      | 22.93       |
| Fourth quarter      | 15.56      | 22.40       |

**Holders**

As of October 31, 2011, there were 791 stockholders of record of our common stock.

**Dividend Policy**

We have never declared or paid any cash dividends on our common stock. We currently expect to retain future earnings, if any, to finance the growth and development of our business and do not anticipate paying any cash dividends in the foreseeable future. Furthermore, the terms of our credit facility place restrictions on our ability to pay dividends, except for stock dividends.

**Issuer Purchases of Equity Securities**

We have not announced any currently effective authorization to repurchase shares of our common stock. We did, however, repurchase 8,514,120 shares of our common stock for \$200 million in connection with our sale of \$690 million of 2.75% convertible debentures in October 2011.

**Item 6. Selected Consolidated Financial Data**

The following selected consolidated financial data is not necessarily indicative of the results of future operations and should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K (as adjusted for the retrospective application of FASB ASC 470-20 in 2009, 2008 and 2007).

|   | Fiscal Year Ended September 30, |            |           |           |           |
|---|---------------------------------|------------|-----------|-----------|-----------|
|   | 2011                            | 2010       | 2009      | 2008      | 2007      |
| <b>Operations:</b>                                  |                                 |            |           |           |           |
| Total revenues                                      | \$ 1,318.7                      | \$ 1,118.9 | \$ 950.4  | \$ 868.5  | \$ 602.0  |
| Gross profit  | 818.9                           | 709.6      | 590.8     | 552.8     | 404.1     |
| Income from operations                              | 52.6                            | 32.9       | 57.6      | 32.6      | 39.0      |
| (Benefit) provision for income taxes                | (8.2)                           | 18.0       | 40.4      | 14.6      | 22.5      |
| Net income (loss)                                   | \$ 38.2                         | \$ (19.1)  | \$ (19.4) | \$ (37.0) | \$ (14.9) |
| <b>Net Income(Loss) Per Share Data:</b>             |                                 |            |           |           |           |
| Basic   | \$ 0.13                         | \$ (0.07)  | \$ (0.08) | \$ (0.18) | \$ (0.08) |
| Diluted   | \$ 0.12                         | \$ (0.07)  | \$ (0.08) | \$ (0.18) | \$ (0.08) |
| <b>Weighted average common shares outstanding:</b>  |                                 |            |           |           |           |
| Basic   | 302.3                           | 287.4      | 253.6     | 209.8     | 176.4     |
| Diluted   | 316.0                           | 287.4      | 253.6     | 209.8     | 176.4     |
| <b>Financial Position:</b>                          |                                 |            |           |           |           |
| Cash and cash equivalents and marketable securities | \$ 478.5                        | \$ 550.0   | \$ 527.0  | \$ 261.6  | \$ 187.0  |
| Total assets  | 4,095.3                         | 3,769.7    | 3,499.5   | 2,846.0   | 2,172.6   |
| Long-term debt, net of current portion              | 853.0                           | 851.0      | 848.9     | 847.3     | 846.1     |
| Total stockholders’ equity                          | 2,493.4                         | 2,297.2    | 2,043.0   | 1,471.7   | 931.9     |
| <b>Selected Data and Ratios:</b>                    |                                 |            |           |           |           |
| Working capital                                     | \$ 379.9                        | \$ 459.2   | \$ 376.6  | \$ 133.5  | \$ 164.9  |
| Depreciation of property and equipment              | 27.6                            | 21.6       | 18.7      | 16.4      | 12.1      |
| Amortization of intangible assets                   | 143.3                           | 135.6      | 115.4     | 82.6      | 37.7      |
| Gross margin percentage                             | 62.1%                           | 63.4%      | 62.2%     | 63.7%     | 67.1%     |

**Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

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

**Forward-Looking Statements**

This Annual Report on Form 10-K 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 revenue, cost of revenue, research and development expenses, selling, general and administrative expenses, amortization of intangible assets and gross margin;
- our strategy relating to our segments;

- the potential of future product releases;
- our product development plans and investments in research and development;
- future acquisitions, and anticipated benefits from acquisitions;
- international operations and localized versions of our products; and
- legal proceedings and litigation matters.

You can identify these and other forward-looking statements by the use of words such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “intends,” “potential,” “continue” or the negative of such 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 Annual Report on Form 10-K.

You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

## Overview

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

Effective in the fourth quarter of fiscal 2011, we are organized in four segments; Healthcare, Mobile and Consumer, Enterprise, and Imaging. Our solutions and services address our four segments:

- *Healthcare.* We provide comprehensive dictation and transcription solutions and services that automate the input and management of medical information. Our hosted and on-premise solutions provide platforms to generate and distribute clinical documentation through the use of advanced dictation and transcription features, and allow us to deliver scalable, highly productive medical transcription solutions. Our solutions also enable us to accelerate future innovation to transform the way healthcare providers document patient care, through improved interface with electronic medical records and extraction of clinical information to support the billing and insurance reimbursement processes. We also offer speech recognition solutions for radiology, cardiology, pathology and related specialties, that help healthcare providers dictate, edit and sign reports without manual transcription. Trends in our healthcare business include a growing customer preference for hosted solutions, increasing interest in the use of mobile devices to access healthcare systems and records, and increasing international interest. We are also seeing increased demand for transactions which involve the sale and delivery of both software and non-software related services or products, which may benefit from the application of Financial Accounting Standards board (“FASB”) Accounting Standards Codification (“ASC”) 605, *Revenue Recognition*. Over the last several quarters, we have signed several new contracts for our hosted solutions, and the volume of lines processed in these services has steadily increased. We are investing to expand our product set to address these opportunities, expand our international capabilities, and reduce our time from contract signing to initiation of billable services.
- *Mobile and Consumer.* Our portfolio of mobile and consumer solutions and services includes an integrated suite of voice control and text-to-speech solutions, dictation applications, predictive text technologies, mobile messaging services and emerging services such as dictation, Web search and voicemail-to-text. Our suite of Dragon general purpose desktop and portable computer dictation applications increases productivity by using speech to create documents, streamline repetitive and complex tasks, input data, complete forms

and automate manual transcription processes. In particular, we have focused in recent quarters on integrating our Dragon technology and brand initiatives across mobile and consumer markets. Trends in our mobile-consumer segment include device manufacturers requiring custom applications to deliver unique and differentiated products, broadening keyboard technologies to take advantage of touch screens, increasing hands-free capabilities on cell phones and automobiles to address the growing concern of distracted driving, and the adoption of our technology on a broadening scope of devices, such as televisions, set-top boxes, e-book readers and tablet computers. We are also seeing increased demand for transactions which involve the sale and delivery of both software and non-software related services or products, which may benefit from the application of ASC 605. We are investing to increase our capabilities and capacity to help device manufacturers build custom applications, to increase the capacity of our data centers, to increase the number, kinds and capacity of network services, to enable developers to access our technology, and to expand both awareness and channels for our direct-to-consumer products.

- *Enterprise.* We deliver a portfolio of customer service business intelligence and authentication solutions that are designed to help companies better support, understand and communicate with their customers. Our solutions include the use of technologies such as speech recognition, natural language understanding, text-to-speech, biometric voice recognition and analytics to automate caller identification and authorization, call steering, completion of tasks such as updates, purchases and information retrieval, and automated outbound notifications. Our solutions improve the customer experience, increase the use of self-service and enable new revenue opportunities. In addition, we offer solutions that can meet customer care needs through direct interaction with thin-client applications on cell phones, enabling customers to very quickly retrieve relevant information. Trends in our enterprise business include increasing interest in the use of mobile applications to access customer care systems and records, increasing interest in coordinating actions and data across customer care channels, and the ability of a broader set of hardware providers and systems integrators to serve the market. We are investing to expand our product set to address these opportunities, to increase efficiency of our hosted applications, expand our capabilities and capacity to help customers build custom applications, and broaden our relationships with new hardware and systems integrator partners serving the market.
- *Imaging.* Our imaging solutions offer optical character recognition technology to deliver highly accurate document scanning and storage. We provide networked print management and comprehensive PDF applications designed specifically for business users. In addition, we offer applications that combine network scanning, network print management and PDF creation to quickly enable distribution of documents to users' desktops or to enterprise applications. Our host of services includes software development toolkits for independent software vendors. The imaging market is evolving to include more networked solutions, mobile access to networked solutions, and multi-function devices. We are investing to improve mobile access to our networked products, expand our distribution channels and embedding relationships, and expand our language coverage.

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

We have built a world-class portfolio of intellectual property, technologies, applications and solutions through both internal development and acquisitions. We expect to continue to pursue opportunities to broaden these assets and expand our customer base through acquisitions.

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



## Strategy

In fiscal 2012, we will continue to focus on growth by providing market-leading, value-added solutions for our customers and partners through a broad set of technologies, service offerings and channel capabilities. We will also continue to focus on operating efficiencies, expense discipline and acquisition synergies to improve gross margins and operating margins. We intend to pursue growth through the following key elements of our strategy:

- *Extend Technology Leadership.* Our solutions are recognized as among the best in their respective categories. We intend to leverage our global research and development organization and broad portfolio of technologies, applications and intellectual property to foster technological innovation and maintain customer preference for our solutions. We also intend to invest in our engineering resources and seek new technological advancements that further expand the addressable markets for our solutions.
- *Broaden Expertise in Vertical Markets.* Businesses are increasingly turning to Nuance for comprehensive solutions rather than for a single technology product. We intend to broaden our expertise and capabilities to deliver targeted solutions for a range of industries including mobile device manufacturers, healthcare, telecommunications, financial services and government administration. We also intend to expand our global sales and professional services capabilities to help our customers and partners design, integrate and deploy innovative solutions.
- *Increase Subscription and Transaction Based Recurring Revenue.* We intend to increase our subscription and transaction based offerings in our segments. The expansion of our subscription or transaction based solutions will enable us to deliver applications that our customers use on a repeat basis, and pay for on a per use basis, providing us with the opportunity to enjoy the benefits of recurring revenue streams.
- *Expand Global Presence.* We intend to further expand our international resources to better serve our global customers and partners and to leverage opportunities in emerging markets such as Asia and Latin America. We continue to add regional executives and sales employees in different geographic regions to better address demand for voice and language based solutions and services.
- *Pursue Strategic Acquisitions and Partnerships.* We have selectively pursued strategic acquisitions to expand our technology, solutions and resources to complement our organic growth. We have also formed key partnerships with other important companies in our markets of interest, and intend to continue to do so in the future where it will enhance the value of our business. We have proven experience in integrating businesses and technologies and in delivering enhanced value to our customers, partners, employees and shareholders. We intend to continue to pursue acquisitions that enhance our solutions, serve specific vertical markets and strengthen our technology portfolio.

## Key Metrics

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

- Total revenue increased by \$199.8 million to \$1,318.7 million;
- Net income improved by \$57.3 million to \$38.2 million;
- Gross margins decreased by 1.3 percentage points to 62.1%;
- Operating margins increased by 1.1 percentage point to 4.0%; and
- Cash provided by operating activities for the fiscal year ended September 30, 2011 was \$357.4 million, an increase of \$61.1 million from the prior fiscal year.

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

- Annualized line run-rate in our on-demand healthcare solutions increased 19% to approximately 4.0 billion lines per year. The annualized line run-rate is determined using billed equivalent line counts in a given quarter, multiplied by four;
- Estimated 3-year value of on-demand contracts increased 17% to approximately \$1.3 billion. We determine this value by using our best estimate of all anticipated future revenue streams under signed on-demand contracts currently in place, whether or not they are guaranteed through a minimum commitment clause. Our best estimate is based on assumptions about launch dates, volumes and renewal rates within the three year period. Most of these contracts are priced by volume of usage and typically have no or low minimum commitments. Actual revenue could vary from our estimates due to factors such as cancellations, non-renewals or volume fluctuations.

## RESULTS OF OPERATIONS

### Total Revenues

The following tables show total revenues by product type and revenue by geographic location, based on the location of our customers, in dollars and percentage change (dollars in millions):

|                                   | Fiscal<br>2011    | Fiscal<br>2010    | Fiscal<br>2009  | %<br>Change<br>2011 vs<br>2010 | %<br>Change<br>2010 vs<br>2009 |
|-----------------------------------|-------------------|-------------------|-----------------|--------------------------------|--------------------------------|
| Product and licensing             | \$ 607.4          | \$ 473.5          | \$ 373.4        | 28.3%                          | 26.8%                          |
| Professional services and hosting | 509.1             | 463.5             | 411.4           | 9.8%                           | 12.7%                          |
| Maintenance and support           | 202.2             | 181.9             | 165.6           | 11.2%                          | 9.8%                           |
| Total Revenues                    | <u>\$ 1,318.7</u> | <u>\$ 1,118.9</u> | <u>\$ 950.4</u> | 17.9%                          | 17.7%                          |
| United States                     | \$ 963.7          | \$ 802.0          | \$ 706.9        | 20.2%                          | 13.5%                          |
| International                     | 355.0             | 316.9             | 243.5           | 12.0%                          | 30.1%                          |
| Total Revenues                    | <u>\$ 1,318.7</u> | <u>\$ 1,118.9</u> | <u>\$ 950.4</u> | 17.9%                          | 17.7%                          |

#### *Fiscal 2011 Compared to Fiscal 2010*

The geographic split for fiscal 2011 was 73% of total revenue in the United States and 27% internationally, as compared to 72% of total revenue in the United States and 28% internationally for the same period last year. The increase in the proportion of revenue generated domestically was primarily due to contributions from our Healthcare on-demand solutions, which are sold predominantly in the United States.

#### *Fiscal 2010 Compared to Fiscal 2009*

The geographic split for fiscal 2010 was 72% of total revenue in the United States and 28% internationally, as compared to 74% of total revenue in the United States and 26% internationally for the same period last year. The increase in the proportion of revenue generated internationally was primarily due to contributions from our acquisition of PSRS near the end of fiscal 2008.

**Product and Licensing Revenue**

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

|                                   | <u>Fiscal<br/>2011</u> | <u>Fiscal<br/>2010</u> | <u>Fiscal<br/>2009</u> | <u>%<br/>Change<br/>2011 vs<br/>2010</u> | <u>%<br/>Change<br/>2010 vs<br/>2009</u> |
|-----------------------------------|------------------------|------------------------|------------------------|--|--|
| Product and licensing revenue     | \$607.4                | \$473.5                | \$373.4                | 28.3%                                    | 26.8%                                    |
| As a percentage of total revenues | 46.1%                  | 42.3%                  | 39.3%                  |  |  |

***Fiscal 2011 Compared to Fiscal 2010***

The increase in product and licensing revenue for fiscal 2011, as compared to fiscal 2010, consisted of a \$50.1 million increase in Mobile and Consumer revenue primarily driven by \$31.6 million of growth in sales of our embedded solutions, and additional sales of \$18.5 million of Dragon products. Imaging revenue increased by \$43.9 million, due to increased revenue from our multi-functional peripheral (“MFP”) products. Healthcare revenue increased by \$23.0 million resulting in part from continued strength in Dragon Medical solutions, which represented \$12.8 million of the increase during the year. Enterprise on-premise license sales increased by \$16.9 million resulting from the continued increase in global demand for our core speech solutions. The growth in our product and licensing revenue streams outpaced the relative growth of our other revenue types, resulting in the 3.8 percentage point increase as a percent of total revenue.

***Fiscal 2010 Compared to Fiscal 2009***

The increase in product and licensing revenue for fiscal 2010, as compared to fiscal 2009, consisted of a \$57.8 million increase in Mobile and Consumer revenue primarily driven by \$43.5 million of growth in sales of our embedded solutions, and a \$14.4 million growth in sales of our Dragon product resulting from our fourth quarter launch of Dragon Naturally Speaking 11. Healthcare revenue increased by \$37.7 million. Imaging revenue increased \$9.8 million primarily as a result of our acquisitions of eCopy and X-Solutions in fiscal 2009. Enterprise revenue decreased \$5.3 million primarily due to the continued migration of customers to our on-demand solutions. The growth in our product and licensing revenue streams outpaced the relative growth of our other revenue types, resulting in the 3.0 percentage point increase as a percent of total revenue.

**Professional Services and Hosting Revenue**

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

|   | <u>Fiscal<br/>2011</u> | <u>Fiscal<br/>2010</u> | <u>Fiscal<br/>2009</u> | <u>%<br/>Change<br/>2011 vs<br/>2010</u> | <u>%<br/>Change<br/>2010 vs<br/>2009</u> |
|---|------------------------|------------------------|------------------------|--|--|
| Professional services and hosting revenue | \$509.1                | \$463.5                | \$411.4                | 9.8%                                     | 12.7%                                    |
| As a percentage of total revenues         | 38.6%                  | 41.4%                  | 43.3%                  |  |  |

***Fiscal 2011 Compared to Fiscal 2010***

The increase in professional services and hosting revenue for fiscal 2011, as compared to fiscal 2010, consisted of a \$40.1 million increase in Healthcare revenue primarily driven by transactional volume growth in our on-demand solutions. Mobile and Consumer revenue increased \$29.3 million as a result of growth of \$19.2 million in our connected mobile services and growth of \$10.1 million in professional services for our embedded solutions.

Enterprise revenue decreased by \$24.4 million, primarily due to the decline of one on-demand customer's volume. As a percentage of total revenue, professional services and hosting revenue decreased 2.8 percentage points as compared to the corresponding period in the prior year, primarily due to the strong growth in the product and licensing revenue relative to professional services and hosting revenue.

#### ***Fiscal 2010 Compared to Fiscal 2009***

The increase in professional services and hosting revenue for fiscal 2010, as compared to fiscal 2009, consisted of a \$31.8 million increase in Healthcare revenue resulting largely from transactional volume growth in our on-demand solutions. Mobile and Consumer revenue increased \$28.5 million primarily due to contributions from our connected mobile services driven by the acquisition of SpinVox in December 2009. Enterprise revenue decreased by \$9.4 million. As a percentage of total revenue, professional services and hosting revenue decreased 1.9 percentage points as compared to the corresponding period in the prior year, primarily due to the strong growth in the product and licensing revenue relative to professional services and hosting revenue.

#### **Maintenance and Support Revenue**

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

|                                   | <u>Fiscal<br/>2011</u> | <u>Fiscal<br/>2010</u> | <u>Fiscal<br/>2009</u> | <u>%<br/>Change<br/>2011 vs<br/>2010</u> | <u>%<br/>Change<br/>2010 vs<br/>2009</u> |
|-----------------------------------|------------------------|------------------------|------------------------|--|--|
| Maintenance and support revenue   | <u>\$202.2</u>         | <u>\$181.9</u>         | <u>\$165.6</u>         | 11.2%                                    | 9.8%                                     |
| As a percentage of total revenues | <u>15.3%</u>           | <u>16.3%</u>           | <u>17.4%</u>           |  |  |

#### ***Fiscal 2011 Compared to Fiscal 2010***

The increase in maintenance and support revenue for fiscal 2011, as compared to fiscal 2010, was driven by growth in our product and licensing sales. The increase included a \$7.5 million increase in Healthcare driven by Dragon Medical solutions, a \$5.5 million increase in Enterprise, and a \$5.3 million increase in Imaging with contributions from our acquisition of Equitrac.

#### ***Fiscal 2010 Compared to Fiscal 2009***

The increase in maintenance and support revenue for fiscal 2010, as compared to fiscal 2009, consisted primarily of a \$6.4 million increase in Enterprise revenue, driven by continued organic growth, a \$5.6 million increase in Healthcare revenue as a result of the expansion of our current installed base and a \$2.4 million increase in Imaging revenue primarily due to contributions from growth in sales of our core imaging products and our acquisition of X-Solutions.

## COSTS AND EXPENSES

### Cost of Product and Licensing Revenue

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

|  | Fiscal<br>2011 | Fiscal<br>2010 | Fiscal<br>2009 | %<br>Change<br>2011 vs<br>2010 | %<br>Change<br>2010 vs<br>2009 |
|--|----------------|----------------|----------------|--------------------------------|--------------------------------|
| Cost of product and licensing revenue            | \$65.6         | \$49.6         | \$37.3         | 32.3%                          | 33.0%                          |
| As a percentage of product and licensing revenue | 10.8%          | 10.5%          | 10.0%          |                                |                                |

#### *Fiscal 2011 Compared to Fiscal 2010*

The increase in cost of product and licensing revenue for fiscal 2011, as compared to fiscal 2010, was primarily due to an increase in hardware costs associated with increased revenues from our MFP products in the Imaging segment. Gross margin remained relatively flat during the period.

#### *Fiscal 2010 Compared to Fiscal 2009*

The increase in cost of product and licensing revenue for fiscal 2010, as compared to fiscal 2009, was primarily due to a \$3.1 million increase in Mobile and Consumer costs driven primarily by revenue growth in Dragon products resulting from our fourth quarter launch of Dragon NaturallySpeaking 11, as well as a \$4.6 million increase in Healthcare costs primarily related to increased sales of Dragon Medical. The cost of product and licensing revenue also increased as a result of a \$2.3 million increase in Imaging costs related to our eCopy acquisition and a \$2.4 million increase in Enterprise costs. Gross margin remained relatively flat during the period.

### Cost of Professional Services and Hosting Revenue

Cost of professional services and hosting revenue primarily consists of compensation for consulting personnel, outside consultants and overhead, as well as the hardware and communications fees that support our hosting solutions. The following table shows cost of professional services and hosting revenue, in dollars and as a percentage of professional services and hosting revenue (dollars in millions):

|  | Fiscal<br>2011 | Fiscal<br>2010 | Fiscal<br>2009 | %<br>Change<br>2011 vs<br>2010 | %<br>Change<br>2010 vs<br>2009 |
|--|----------------|----------------|----------------|--------------------------------|--------------------------------|
| Cost of professional services and hosting revenue            | \$341.1        | \$280.7        | \$254.8        | 21.5%                          | 10.2%                          |
| As a percentage of professional services and hosting revenue | 67.0%          | 60.6%          | 61.9%          |                                |                                |

#### *Fiscal 2011 Compared to Fiscal 2010*

The increase in cost of professional services and hosting revenue for fiscal 2011, as compared to fiscal 2010, was due to a \$29.6 million increase in Healthcare costs primarily related to growth in our on-demand solutions, and a \$16.8 million increase in stock-based compensation related to our professional services personnel. Gross margin relative to our professional services and hosting revenue decreased 6.4 percentage points primarily due to increased stock-based compensation expense reducing gross margin by 3.3 percentage points and the remainder is primarily related to volume and revenue declines from one on-demand Enterprise customer.

***Fiscal 2010 Compared to Fiscal 2009***

The increase in cost of professional services and hosting revenue for fiscal 2010, as compared to fiscal 2009, was primarily due to a \$35.9 million increase in Mobile and Consumer costs driven by growth in our connected mobile services, a \$1.5 million increase in Healthcare and a \$1.4 million increase in Imaging costs driven by our eCopy acquisition. These increases are partially offset by a \$12.8 million decrease in Enterprise costs. Gross margin relative to our professional services and hosting revenue increased 1.3 percentage points primarily due to growth in our higher margin healthcare on-demand business and improved professional services utilization rates.

**Cost of Maintenance and Support Revenue**

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

|  | <u>Fiscal<br/>2011</u> | <u>Fiscal<br/>2010</u> | <u>Fiscal<br/>2009</u> | <u>%<br/>Change<br/>2011 vs<br/>2010</u> | <u>%<br/>Change<br/>2010 vs<br/>2009</u> |
|--|------------------------|------------------------|------------------------|--|--|
| Cost of maintenance and support revenue            | <u>\$ 38.1</u>         | <u>\$ 31.3</u>         | <u>\$ 29.1</u>         | 21.7%                                    | 7.6%                                     |
| As a percentage of maintenance and support revenue | <u>18.8%</u>           | <u>17.2%</u>           | <u>17.6%</u>           |  |  |

***Fiscal 2011 Compared to Fiscal 2010***

The increase in cost of maintenance and support revenue for fiscal 2011, as compared to fiscal 2010, included \$2.5 million increase in costs due to higher volumes of Enterprise application maintenance and support, a \$2.1 million increase in costs related to increased revenue from our MFP products in our Imaging business, which included the impact from our acquisition of Equitrac, and a \$1.4 million increase in stock-based compensation expense. The increase in stock-based compensation expense reduced gross margin by 0.7% during the period. Excluding impact from stock-based compensation, gross margin remained relatively flat during the period.

***Fiscal 2010 Compared to Fiscal 2009***

The increase in cost of maintenance and support revenue for fiscal 2010, as compared to fiscal 2009, was primarily due to a \$1.8 million increase in Imaging costs as a result of our eCopy and X-solutions acquisitions. Gross margin relative to our maintenance and support revenue remained relatively constant during the period.

**Research and Development Expense**

Research and development expense primarily consists of salaries, benefits and overhead relating to engineering staff. The following table shows research and development expense, in dollars and as a percentage of total revenue (dollars in millions):

|                                   | <u>Fiscal<br/>2011</u> | <u>Fiscal<br/>2010</u> | <u>Fiscal<br/>2009</u> | <u>%<br/>Change<br/>2011 vs<br/>2010</u> | <u>%<br/>Change<br/>2010 vs<br/>2009</u> |
|-----------------------------------|------------------------|------------------------|------------------------|--|--|
| Research and development expense  | <u>\$179.4</u>         | <u>\$152.1</u>         | <u>\$116.8</u>         | 17.9%                                    | 30.2%                                    |
| As a percentage of total revenues | <u>13.6%</u>           | <u>13.6%</u>           | <u>12.3%</u>           |  |  |

***Fiscal 2011 Compared to Fiscal 2010***

The increase in research and development expense for fiscal 2011, as compared to fiscal 2010, was attributable to a \$28.6 million increase in compensation expense. The increase in compensation expense was driven by a \$14.9 million increase in stock-based compensation expense and headcount growth as we continue to invest in our research and development organization as well as additional headcount from our acquisitions during the period. The

increase was offset by reimbursement of \$5.9 million under a new collaboration agreement signed during the period as discussed in Note 2 to the audited consolidated financial statements.

***Fiscal 2010 Compared to Fiscal 2009***

The increase in research and development expense for fiscal 2010, as compared to fiscal 2009, primarily consisted of a \$16.7 million increase in services from a third party related to the research collaboration agreements discussed in Note 2 to the audited consolidated financial statements, a \$16.5 million increase in compensation expenses attributable to the additional headcount and other resources from our acquisitions during the period, and a \$2.9 million increase in infrastructure investment to support ongoing research and development projects.

**Sales and Marketing Expense**

Sales and marketing expense includes salaries and benefits, commissions, advertising, direct mail, public relations, tradeshow costs and other costs of marketing programs, travel expenses associated with our sales organization and overhead. The following table shows sales and marketing expense, in dollars and as a percentage of total revenue (dollars in millions):

|                                   | <u>Fiscal<br/>2011</u> | <u>Fiscal<br/>2010</u> | <u>Fiscal<br/>2009</u> | <u>%<br/>Change<br/>2011 vs<br/>2010</u> | <u>%<br/>Change<br/>2010 vs<br/>2009</u> |
|-----------------------------------|------------------------|------------------------|------------------------|--|--|
| Sales and marketing expense       | \$306.4                | \$266.2                | \$217.8                | 15.1%                                    | 22.2%                                    |
| As a percentage of total revenues | 23.2%                  | 23.8%                  | 22.9%                  |  |  |

***Fiscal 2011 Compared to Fiscal 2010***

The increase in sales and marketing expense for fiscal 2011, as compared to fiscal 2010, was primarily attributable to a \$21.7 million increase in compensation expense. The increase in expense was driven primarily by additional headcount to support growth and a \$5.1 million increase in stock-based compensation expense. Additionally, marketing and channel program spending increased \$14.0 million to drive overall revenue growth.

***Fiscal 2010 Compared to Fiscal 2009***

The increase in sales and marketing expense for fiscal 2010, as compared to fiscal 2009, was primarily attributable to a \$35.4 million increase in compensation, including an \$11.1 million increase in stock-based compensation expense driven primarily by the increase in grant values resulting from increase in our stock price, and other variable costs such as commissions and travel expenses. An \$8.0 million increase in marketing program spending, including marketing communications and channel programs, related to new products launched during the fourth quarter of fiscal 2010.

**General and Administrative Expense**

General and administrative expense primarily consists of personnel costs for administration, finance, human resources, information systems, facilities and general management, fees for external professional advisors including accountants and attorneys, insurance, and provisions for doubtful accounts. The following table shows general and administrative expense, in dollars and as a percentage of total revenue (dollars in millions):

|                                    | <u>Fiscal<br/>2011</u> | <u>Fiscal<br/>2010</u> | <u>Fiscal<br/>2009</u> | <u>%<br/>Change<br/>2011 vs<br/>2010</u> | <u>%<br/>Change<br/>2010 vs<br/>2009</u> |
|------------------------------------|------------------------|------------------------|------------------------|--|--|
| General and administrative expense | \$147.6                | \$122.1                | \$100.5                | 20.9%                                    | 21.5%                                    |
| As a percentage of total revenues  | 11.2%                  | 10.9%                  | 10.6%                  |  |  |

***Fiscal 2011 Compared to Fiscal 2010***

The increase in general and administrative expense for fiscal 2011, as compared to fiscal 2010, was primarily attributable to a \$14.5 million increase in compensation expense and a \$9.1 million increase in legal costs associated with on-going litigation and intellectual property maintenance. The increase in compensation expense was driven primarily by additional headcount due to operational growth and our acquisitions during the period and an \$8.9 million increase in stock-based compensation expense.

***Fiscal 2010 Compared to Fiscal 2009***

The increase in general and administrative expense for fiscal 2010, as compared to fiscal 2009, was primarily attributable to \$16.9 million increase in compensation driven primarily by increase in stock-based compensation grant values resulting from the increase in our stock price, \$2.3 million increase in other compensation expense and a \$2.8 million increase in legal costs associated with on-going litigation and intellectual property maintenance. This increase is partially offset by a reduction of \$3.0 million in temporary employees and professional services as a result of cost containment efforts and acquisition related synergies.

**Amortization of Intangible Assets**

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

|                                   | Fiscal<br>2011 | Fiscal<br>2010 | Fiscal<br>2009 | %<br>Change<br>2011 vs<br>2010 | %<br>Change<br>2010 vs<br>2009 |
|-----------------------------------|----------------|----------------|----------------|--------------------------------|--------------------------------|
| Cost of revenue                   | \$ 55.1        | \$ 47.8        | \$ 38.4        | 15.3%                          | 24.5%                          |
| Operating expense                 | 88.2           | 87.8           | 77.0           | 0.5%                           | 14.0%                          |
| Total amortization expense        | <u>\$143.3</u> | <u>\$135.6</u> | <u>\$115.4</u> | 5.7%                           | 17.5%                          |
| As a percentage of total revenues | <u>10.9%</u>   | <u>12.1%</u>   | <u>12.1%</u>   |                                |                                |

***Fiscal 2011 Compared to Fiscal 2010***

The increase in amortization of intangible assets for fiscal 2011, as compared to fiscal 2010, was primarily attributable to the amortization of acquired technology and patent intangible assets from our business acquisitions during fiscal 2011 and our acquisitions of patents and technology from third-parties during the fiscal 2010.

***Fiscal 2010 Compared to Fiscal 2009***

The increase in amortization of intangible assets for fiscal 2010, as compared to fiscal 2009, was primarily attributable to the amortization of acquired customer relationship and technology and patent intangible assets from our acquisitions of eCopy in September 2009 and SpinVox in December 2009. Fiscal 2010 amortization expense also increased over fiscal 2009 due to our acquisition and licensing of certain technology from third-parties during fiscal 2009 and 2010.

Based on our balance of amortizable intangible assets as of September 30, 2011, and assuming no impairment or change in useful lives, we expect amortization of intangible assets for fiscal 2012 to be \$141.7 million.

**Acquisition-Related Costs, Net**

Acquisition-related costs include those costs related to business and other acquisitions, including potential acquisitions. These costs consist of (i) transition and integration costs, including retention payments, transitional



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employee costs and earn-out payments treated as compensation expense, as well as the costs of integration-related services provided by third-parties; (ii) professional service fees, including direct third-party costs of the transaction and post-acquisition legal and other professional service fees associated with disputes and regulatory matters related to acquired entities; and (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. Acquisition-related costs were recorded as follows (dollars in millions):

|                                      | <u>Fiscal</u><br><u>2011</u> | <u>Fiscal</u><br><u>2010</u> | <u>Fiscal</u><br><u>2009</u> | <u>%</u><br><u>Change</u><br><u>2011 vs</u><br><u>2010</u> | <u>%</u><br><u>Change</u><br><u>2010 vs</u><br><u>2009</u> |
|--------------------------------------|------------------------------|------------------------------|------------------------------|--|--|
| Transition and integration costs     | \$ 3.4                       | \$ 13.6                      | \$ 4.7                       | (75.0)%  | 189.4%   |
| Professional service fees            | 18.0                         | 17.1                         | 15.0                         | 5.3%   | 14.0%  |
| Acquisition-related adjustments      | 0.5                          | (0.1)                        | (4.0)                        | (600.0)%   | (97.5)%  |
| Total Acquisition-related costs, net | <u>\$21.9</u>                | <u>\$30.6</u>                | <u>\$15.7</u>                | (28.4)%  | 94.9%  |
| As a percentage of total revenue     | <u>1.7%</u>                  | <u>2.7%</u>                  | <u>1.7%</u>                  |  |  |

***Fiscal 2011 Compared to Fiscal 2010***

The decrease in acquisition-related costs, net for fiscal 2011, as compared to fiscal 2010, was primarily driven by the reduction in transition and integration costs. For fiscal 2010, \$8.9 million of transition and integration costs was driven by our acquisitions of eCopy and SpinVox.

***Fiscal 2010 Compared to Fiscal 2009***

The increase in acquisition-related costs, net for fiscal year 2010, as compared to fiscal 2009, was largely a result of our adoption of ASC 805, *Business Combinations*, on October 1, 2009, which requires that transaction costs related to acquisitions be expensed as incurred. We recognized approximately \$9.4 million in transaction costs, included within professional service fees above, during fiscal 2010 that would have been included as part of the consideration transferred and capitalized in periods prior to our adoption of ASC 805. This includes \$2.2 million that had been capitalized as of September 30, 2009 related to costs incurred in prior periods that was required to be expensed upon our adoption of ASC 805. The remainder of the increase was primarily attributable to an \$8.9 million increase in transition and integration costs primarily driven by our acquisitions of eCopy and SpinVox.

**Restructuring and Other Charges, Net**

The following table sets forth the activity relating to the restructuring accruals included in Restructuring and Other Charges, net, in fiscal 2011, 2010 and 2009 (dollars in millions):

|                                      | <u>Personnel<br/>Related</u> | <u>Facilities<br/>Costs</u> | <u>Other</u> | <u>Total</u>  |
|--------------------------------------|------------------------------|-----------------------------|--------------|---------------|
| Balance at September 30, 2008        | 0.3                          | 0.8                         | 1.4          | 2.5           |
| Restructuring and other charges, net | 5.3                          | 0.1                         | —            | 5.4           |
| Cash payments                        | <u>(5.0)</u>                 | <u>(0.6)</u>                | <u>(1.4)</u> | <u>(7.0)</u>  |
| Balance at September 30, 2009        | 0.6                          | 0.3                         | —            | 0.9           |
| Restructuring and other charges, net | 9.6                          | 0.2                         | 8.9          | 18.7          |
| Non-cash adjustments                 | —                            | —                           | (6.8)        | (6.8)         |
| Cash payments                        | <u>(8.4)</u>                 | <u>(0.2)</u>                | <u>(2.1)</u> | <u>(10.7)</u> |
| Balance at September 30, 2010        | 1.8                          | 0.3                         | —            | 2.1           |
| Restructuring and other charges, net | 9.1                          | 1.9                         | 12.0         | 23.0          |
| Non-cash adjustments                 | 0.2                          | —                           | (11.9)       | (11.7)        |
| Cash payments                        | <u>(6.0)</u>                 | <u>(1.2)</u>                | <u>(0.1)</u> | <u>(7.3)</u>  |
| Balance at September 30, 2011        | <u>\$ 5.1</u>                | <u>\$ 1.0</u>               | <u>\$ —</u>  | <u>\$ 6.1</u> |

For fiscal 2011, we recorded net restructuring and other charges of \$23.0 million, which consisted primarily of an \$11.7 million impairment charge related to our Dictaphone trade name resulting from a recent change in our Healthcare marketing strategy under which we plan to consolidate our brands and will no longer be using the Dictaphone trade name in our new product offerings. In addition, we recorded a \$9.1 million charge related to the elimination of approximately 200 personnel across multiple functions primarily to eliminate duplicative positions as a result of businesses acquired during the year and a \$1.9 million charge related to the elimination or consolidation of excess facilities.

For fiscal 2010, we recorded net restructuring and other charges of \$18.7 million, which consisted primarily of \$9.6 million related to the elimination of approximately 175 personnel across multiple functions within our company, including acquired entities, a \$6.8 million write-off of previously capitalized patent defense costs as a result of unsuccessful litigation and \$2.1 million of contract termination costs. Excluding the \$6.8 million write-off of previously capitalized patent defense costs, restructuring charges increased for fiscal 2010, as compared to fiscal 2009, as a result of the adoption of the business combinations guidance in ASC 805. Under the previous accounting guidance, restructuring costs related to certain post-acquisition activities to integrate acquired companies were generally recorded at the date of acquisition, while the guidance in ASC 805 generally requires that these costs be recorded to the acquiring company's statement of operations as the activities are undertaken.

For fiscal 2009, we recorded restructuring and other charges of \$5.4 million, of which \$5.3 million related to the elimination of approximately 220 personnel across multiple functions within our company.

**Other Income (Expense)**

Other income (expense) consists of interest income, interest expense, gain (loss) from security price guarantee derivatives, gain (loss) from foreign exchange, and gains (losses) from other non-operating activities. The following table shows other income (expense) in dollars and as a percentage of total revenue (dollars in millions):

|                                   | Fiscal<br>2011  | Fiscal<br>2010   | Fiscal<br>2009  | %<br>Change<br>2011 vs<br>2010 | %<br>Change<br>2010 vs<br>2009 |
|-----------------------------------|-----------------|------------------|-----------------|--------------------------------|--------------------------------|
| Interest income                   | \$ 3.2          | \$ 1.2           | \$ 3.6          | 166.7%                         | (66.6)%                        |
| Interest expense                  | (36.7)          | (41.0)           | (47.3)          | 10.5%                          | 13.3%                          |
| Other income, net                 | 11.0            | 5.8              | 7.2             | 89.7%                          | (19.4)%                        |
| Total other income (expense), net | <u>\$(22.5)</u> | <u>\$ (34.0)</u> | <u>\$(36.5)</u> |                                |                                |
| As a percentage of total revenue  | <u>(1.7)%</u>   | <u>(3.0)%</u>    | <u>(3.8)%</u>   |                                |                                |

***Fiscal 2011 Compared to Fiscal 2010***

The decrease in interest expense for fiscal 2011, as compared to fiscal 2010, was primarily driven by decreased interest costs as a result of lower rates on our outstanding variable rate borrowings. The increase in other income, net was primarily driven by a \$9.3 million increase in gains on our security price guarantee derivatives. This was offset by a decrease in foreign exchange gains of \$4.7 million resulting from our implementation of a hedging program in fiscal 2011 to reduce our exposure to changes in foreign currency exchange rates.

***Fiscal 2010 Compared to Fiscal 2009***

The change in other income, net for fiscal 2010, as compared to fiscal 2009, was primarily driven by changes in foreign exchange as a result of the U.S. dollar and British pound strengthening against the euro primarily in the first three quarters of fiscal 2010, offset by a one time gain taken in 2009 relating to the foreign currency contracts that were not designated as hedges in fiscal 2009. Interest income and interest expense were lower due to lower prevailing market rates.

**(Benefit) provision for Income Taxes**

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

|                                | Fiscal<br>2011 | Fiscal<br>2010    | Fiscal<br>2009 | % %<br>Change<br>2011 vs<br>2010 | %<br>Change<br>2010 vs<br>2009 |
|--------------------------------|----------------|-------------------|----------------|----------------------------------|--------------------------------|
| Income tax (benefit) provision | \$ (8.2)       | \$ 18.0           | \$ 40.4        | (145.6)%                         | (55.4)%                        |
| Effective income tax rate      | <u>(27.4)%</u> | <u>(1,693.3)%</u> | <u>192.3%</u>  |                                  |                                |

***Fiscal 2011 Compared to Fiscal 2010***

Our effective income tax rate was (27.4)% and (1,693.3)% for fiscal 2011 and 2010, respectively. The decrease in the tax provision from 2010 to 2011 was primarily related to a one-time tax benefit recorded in connection with the Equitrac acquisition for which a net deferred tax liability was recorded in purchase accounting, resulting in a release of our valuation allowance of \$34.7 million and therefore a tax benefit during the year. The decrease in the tax provision was also due to a release of \$10.6 million of our valuation allowance associated with the change in characterization of a previously acquired intangible asset from an indefinite life asset to a finite life asset during our fourth quarter of fiscal 2011. These deferred tax benefits were offset by a \$21.4 million increase in our current income tax provision primarily driven by higher U.S. taxable income.

### *Fiscal 2010 Compared to Fiscal 2009*

Our effective income tax rate was (1,693.3)% and 192.3% for fiscal 2010 and 2009, respectively. The decrease in the rate was due partially to the adoption of ASC 805, which no longer requires the release of the valuation allowance on acquired tax assets to be included as a component of goodwill. Under the new standard, such benefits are included in the statements of operations as a reduction to the provision for income taxes. Also contributing to the decrease was an \$8.0 million tax provision recorded during fiscal 2009 upon our election to treat the eScripture acquisition as an asset purchase, as well as a \$3.2 million tax provision recorded during fiscal 2009 as a result of a Massachusetts state tax law enactment relating to the utilization of net operating losses. The decreases were partially offset by an increase in the fiscal 2010 foreign tax provision resulting from increased foreign profits in certain jurisdictions.

### **SEGMENT ANALYSIS**

Prior to the fourth quarter of fiscal 2011, the Company operated in one reportable segment as the Chief Operating Decision Maker (“CODM”) regularly reviewed revenue data by market group, while reviewing gross margins, operating margins, and other measures of income or loss on a consolidated basis to manage the business, allocate resources and assess performance.

Effective in the fourth quarter of fiscal 2011, our CODM commenced regular reviews of the operating results including measures of profitability of each of our market groups; Healthcare, Mobile and Consumer, Enterprise and Imaging. As a result, we have changed our segment structure and identified our four customer-facing market groups as reportable segments as defined by ASC 280, *Segment Reporting*, based on the level of financial information now regularly reviewed by the CODM in allocating resources and assessing performance of each market group.

The Healthcare segment is primarily engaged in voice and language recognition for healthcare information management offered both by licensing and on-demand services. The Mobile and Consumer segment is primarily engaged in sales of voice and language solutions that are embedded in a device (such as a cell phone, car or tablet computer) or installed on a personal computer. Our Enterprise segment offers voice and language solutions by licensing as well as on-demand solutions hosted by us that are designed to help companies better support, understand and communicate with their customers. The Imaging segment sells document capture and print management solutions that are embedded in copiers and multi-function printers as well as packaged software for document management.

Segment revenues include revenue related to acquisitions, primarily from the fiscal 2010 eCopy transaction and the fiscal 2011 purchases of Equitrac and SVOX that would otherwise have been recognized but for the purchase accounting treatment of these transactions. Segment revenues also include revenue that we would have otherwise recognized had we not acquired intellectual property and other assets from the same customer during the same quarter. We include these revenues and the related cost of revenues to allow for more complete comparisons to the financial results of historical operations, forward-looking guidance and the financial results of peer companies and in assessing management performance. Segment profit 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 is an important measure used for evaluating performance and for decision-making purposes. 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 income (expense), net and certain unallocated corporate expenses. Segment profit includes an adjustment for acquisition-related revenues and cost of revenues which includes revenue from acquisitions that would have otherwise been recognized but for the purchase accounting treatment of these transactions. We believe that these adjustments allow for more complete comparisons to the financial results of the historical operations.

|                                    | Fiscal<br>2011    | Fiscal<br>2010    | Fiscal<br>2009  | %<br>Change<br>2011 vs<br>2010 | %<br>Change<br>2010 vs<br>2009 |
|------------------------------------|-------------------|-------------------|-----------------|--------------------------------|--------------------------------|
| <b>Segment Revenues(a)</b>         |                   |                   |                 |                                |                                |
| Healthcare                         | \$ 526.8          | \$ 449.2          | \$ 392.0        | 17.3%                          | 14.6%                          |
| Mobile and Consumer                | 393.3             | 309.5             | 234.1           | 27.1%                          | 32.2%                          |
| Enterprise                         | 296.4             | 296.2             | 310.6           | 0.1%                           | (4.6)%                         |
| Imaging                            | 177.4             | 140.7             | 73.6            | 26.1%                          | 91.2%                          |
| Total segment revenues             | \$ 1,393.9        | \$ 1,195.6        | \$ 1,010.3      | 16.6%                          | 18.3%                          |
| Less: acquisition related revenues | (75.2)            | (76.7)            | (59.9)          | (2.0)%                         | 27.8%                          |
| Total revenues                     | <u>\$ 1,318.7</u> | <u>\$ 1,118.9</u> | <u>\$ 950.4</u> | 17.9%                          | 17.7%                          |
| <b>Segment Profit(b)</b>           |                   |                   |                 |                                |                                |
| Healthcare                         | \$ 269.4          | \$ 227.4          | \$ 184.8        | 18.5%                          | 23.1%                          |
| Mobile and Consumer                | 170.9             | 120.0             | 108.0           | 42.4%                          | 11.1%                          |
| Enterprise                         | 63.3              | 82.3              | 89.6            | (23.1)%                        | (8.1)%                         |
| Imaging                            | 69.1              | 55.6              | 29.8            | 24.3%                          | 86.6%                          |
| Total segment profit               | <u>\$ 572.7</u>   | <u>\$ 485.3</u>   | <u>\$ 412.2</u> | 18.0%                          | 17.7%                          |

a) 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. Segment revenues also include revenue that the business would have otherwise recognized had we not acquired intellectual property and other assets from the same customer. These revenues are included to allow for more complete comparisons to the financial results of historical operations and in evaluating management performance.

(b) Segment profit 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. The costs of acquisition related revenue adjustments are included to allow for more complete comparisons of the historical operations.

## Segment Revenue

### *Fiscal 2011 Compared to Fiscal 2010*

- Healthcare segment revenue increased by \$77.6 million, primarily attributable to revenue growth in both licenses and on-demand solutions. On-demand revenue increased by \$47.2 million due to increased transactional volume and product and licensing revenue increased by \$20.5 million due to volume and continued strong demand of our Healthcare license offerings resulting in part from continued strength in Dragon Medical solutions.
- Mobile and Consumer segment revenue increased by \$83.8 million. Our product and licensing revenue grew \$57.4 million primarily related to growth of \$39.3 million in our embedded handset and automotive products and \$18.1 million in our Dragon products. Our professional services and hosting revenue grew \$24.5 million related to both the increased volume of transactions in our connected mobile services as well as professional services revenue to support the implementation of recent handset and automobile design wins.
- Enterprise segment revenue remained flat from fiscal 2010 to fiscal 2011. Our product and licensing revenue grew \$18.8 million and maintenance and support revenue grew \$6.4 million resulting from the continued increase in global demand for our core speech solutions. These increases were offset by a decline of \$25.0 million in our professional services and hosting revenue, primarily attributable to the decline in volume from one on-demand customer.

- Imaging segment revenue increased by \$36.7 million, primarily attributable to growth in sales from our MFP products, which includes the impact from our acquisition of Equitrac.

***Fiscal 2010 Compared to Fiscal 2009***

- Healthcare segment revenue increased by \$57.2 million, primarily attributable to revenue growth in licenses and on-demand solutions. On-demand revenue increased \$25.5 million due to increased transactional volume and product and licensing revenue increased \$20.7 million due to volume and continued strong demand of our Healthcare license offerings.
- Mobile and Consumer segment revenue increased by \$75.4 million, primarily driven by growth in product and licenses and hosting services for voicemail-to-text. Product and licensing revenue increased \$37.7 million and hosting revenue increased \$30.5 million.
- Enterprise segment revenue decreased by \$14.4 million mainly due to decline in volume from one on-demand customer.
- Imaging segment revenue increased by \$67.1 million, a result of contributions from our acquisitions of eCopy, Inc. and growth in our core imaging solutions. Product and licensing revenue increased \$55.8 million.

**Segment Profit**

***Fiscal 2011 Compared to Fiscal 2010***

- Healthcare segment profit in fiscal 2011 increased 18.5% over fiscal 2010, driven primarily by segment revenue growth of 17.3%. Segment profit increased by 0.5 percentage points as a result of operating expense leverage and a \$5.9 million reimbursement under a new collaboration agreement signed during the period as discussed in Note 2 to the audited consolidated financial statements.
- Mobile and Consumer segment profit in fiscal 2011 increased 42.4% over fiscal 2010, resulting in part from the 27.1% increase in segment revenue. Segment profit margin in fiscal 2011 improved 4.7 percentage points from 38.8% in fiscal 2010 to 43.5% in fiscal 2011. The segment profit margin improvements were driven primarily by embedded and mobile services gross margin improvements, and from leverage in research and development and selling and marketing expenses.
- Enterprise segment profit in fiscal 2011 decreased 23.1% over fiscal 2010, while sales were essentially flat. Segment profit margin in fiscal 2011 declined 6.4 percentage points from 27.8% in fiscal 2010 to 21.4% in fiscal 2011. This decrease was driven by decreased volume and revenue from one on-demand customer resulting in a 3.8 percentage point decrease in segment profit and increased spending in research and development contributed to a 1.7 percentage point decrease in segment profit.
- Imaging segment profit in fiscal 2011 increased 24.3% over fiscal 2010, driven primarily by the 26.1% increase in sales. Segment profit margin in fiscal 2011 remained relatively flat at 39.0% in fiscal 2011 compared to 39.5% in fiscal 2010.

***Fiscal 2010 Compared to Fiscal 2009***

- Healthcare segment profit in fiscal 2010 increased 23.1% over fiscal 2009, driven primarily by segment revenue growth of 14.6%. Segment profit margin in fiscal 2010 improved 3.5 percentage points from 47.1% in fiscal 2009 to 50.6% in fiscal 2010, driven primarily by improvements in our services gross margin.
- Mobile and Consumer segment profit in fiscal 2010 increased 11.1% over fiscal 2009, resulting in part from the 32.2% increase in segment revenue. Segment profit margin in fiscal 2010 decreased 7.3 percentage points from 46.1% in fiscal 2009 to 38.8% in fiscal 2010. The decrease was driven primarily by increased cost of professional and hosting revenue due to our acquisition of SpinVox in December 2009.
- Enterprise segment profit in fiscal 2010 decreased 8.1% over fiscal 2009. Segment profit margin in fiscal 2010 declined 1.0 percentage points from 28.8% in fiscal 2009 to 27.8% in fiscal 2010. Increased sales and marketing expense contributed to the decrease in segment profit.

- Imaging segment profit in fiscal 2010 increased 86.6% over fiscal 2009, driven primarily by the 91.2% increase in segment revenue. Segment profit margin in fiscal 2010 decreased 1.0 percentage point from 40.5% in fiscal 2009 to 39.5% in fiscal 2010. The decrease was driven primarily by increased costs related to our eCopy acquisition.

## LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents totaled \$447.2 million as of September 30, 2011, a decrease of \$69.4 million as compared to \$516.6 million as of September 30, 2010. Our working capital, which at September 30, 2011 included short-term marketable securities of \$31.2 million, was \$379.9 million compared to \$459.2 million of working capital at September 30, 2010. Working capital at September 30, 2010 excluded \$28.3 million of marketable securities that were classified as non-current. Cash and cash equivalents held by our international operations totaled \$61.7 million and \$40.5 million at September 30, 2011 and 2010, respectively. We expect the cash held overseas will continue to be used for our international operations and therefore do not anticipate repatriating these funds. If we were to repatriate these amounts, we do not believe that the withholding taxes payable as a result would have a material impact on our liquidity. As of September 30, 2011, our total accumulated deficit was \$243.1 million. We do not expect our accumulated deficit to impact our future ability to operate the business given our strong cash and operating cash flow positions.

On October 6, 2011, we acquired Swype, Inc., a provider of software that allows users to type by sliding a finger or stylus from letter to letter, for approximately \$77.5 million in cash, plus \$25.0 million in contingent payments, due in eighteen months subject to certain conditions.

On October 24, 2011, we sold \$690 million of 2.75% Convertible Debentures due November 1, 2031. Total proceeds, net of debt issuance costs of approximately \$14.0 million, were \$676.0 million. We used \$200 million of the proceeds to repurchase 8.5 million shares of our common stock. Interest at 2.75% per year is payable in cash semiannually. We believe our current cash and cash equivalents and marketable securities, together with the proceeds of our recent convertible debt issuance are sufficient to meet our operating needs for at least the next twelve months.

### Cash provided by operating activities

#### *Fiscal 2011 Compared to Fiscal 2010*

Cash provided by operating activities for fiscal 2011 was \$357.4 million, an increase of \$61.1 million, or 21%, as compared to cash provided by operating activities of \$296.3 million for fiscal 2010. The increase was primarily driven by the following factors:

- An increase of \$90.0 million in cash flows resulting from an increase in net income, exclusive of non-cash adjustment items which include a one-time non-cash tax benefit adjustment of \$34.7 million reducing the valuation allowance on deferred tax assets as a result of the Equitrac acquisition;
- An increase in cash flows of \$16.8 million from an overall increase in deferred revenue;
- A decrease of \$45.6 million in cash flows generated by changes in working capital excluding deferred revenue, primarily driven by an €18.0 million (\$23.4 million equivalent) payment in fiscal 2011 for a fixed obligation assumed in connection with our acquisition of SpinVox and a \$24.8 million decrease in cash flows due to changes in accounts receivable.

#### *Fiscal 2010 Compared to Fiscal 2009*

Cash provided by operating activities for fiscal 2010 was \$296.3 million, an increase of \$37.6 million, or 15%, as compared to cash provided by operating activities of \$258.7 million for fiscal 2009. The increase was primarily driven by the following factors:

- An increase in cash resulting from a decrease in net loss, after excluding non-cash adjustment items, of approximately \$45.1 million;

- An increase in cash of \$40.2 million from deferred revenue primarily attributable to billings of our eCopy imaging solutions;
- A decrease in cash of \$34.3 million from accounts receivable primarily attributable to improved collection efforts and continuous DSO improvements in 2009, while maintaining consistent receivables balances in 2010; and
- A decrease in cash from accounts payable and accrued expenses of \$23.6 million primarily attributable to the timing of cash payments under our normal operating cycles.

#### **Cash used in investing activities**

##### ***Fiscal 2011 compared to Fiscal 2010***

Cash used in investing activities for fiscal 2011 was \$425.9 million, an increase of \$110.3 million, or 35%, as compared to cash used in investing activities of \$315.6 million for fiscal 2010. The net increase was primarily driven by the following factors:

- An increase in cash outflows of \$198.6 million for acquisitions in fiscal 2011 as compared to fiscal 2010;
- A decrease in net cash outflows of \$34.4 million to purchase marketable securities net of proceeds; and
- A decrease in cash outflows of \$39.3 million related to restricted cash. During fiscal 2011, we received \$17.2 million in cash upon satisfaction of the restriction of our restricted cash. During fiscal 2010, we used \$22.1 million for an irrevocable standby letter of credit account for a fixed obligation in connection with our acquisition of SpinVox in 2010.

##### ***Fiscal 2010 compared to Fiscal 2009***

Cash used in investing activities for fiscal 2010 was \$315.6 million, an increase of \$131.0 million, or 71%, as compared to cash used in investing activities of \$184.6 million for fiscal 2009. The net increase was primarily driven by the following factors:

- An increase in cash payments related to acquisitions of \$104.6 million, primarily driven by the cash paid for the acquisition of SpinVox and other fiscal 2010 business acquisitions, the PSRS deferred acquisitions payments, and the Phonetic earn-out payment;
- Cash payments of \$33.5 million related to our purchase of marketable securities in fiscal 2010;
- A decrease of \$50.6 million in cash used for acquisitions of technology; and
- The use of \$22.1 million in restricted cash related to cash placed in an irrevocable standby letter of credit account for a fixed obligation in connection with our acquisition of SpinVox.

#### **Cash provided by financing activities**

##### ***Fiscal 2011 compared to Fiscal 2010***

Cash provided by financing activities for fiscal 2011 was \$6.0 million, a decrease of \$3.9 million, or 39%, as compared to cash provided by financing activities of \$9.9 million for fiscal 2010. The change was primarily driven by the following factors:

- An increase of \$16.5 million cash benefit resulting from excess tax benefits on employee equity awards;
- An increase in cash outflows of \$14.9 million to net share settle employee equity awards, due to an increase in the number of shares vested and an increase in the intrinsic value of the shares vested as a result of the overall increase in our stock price in fiscal 2011 as compared to fiscal 2010;
- A decrease in cash inflows of \$12.4 million from the sale of our common stock. During fiscal 2010, warrants to purchase 2.5 million of our shares were exercised, whereas we had no warrant activity in fiscal 2011; and



### ***Fiscal 2010 compared to Fiscal 2009***

Cash provided by financing activities for fiscal 2010 was \$9.9 million, a decrease of \$179.5 million, or 95%, as compared to cash provided by financing activities of \$189.4 million for fiscal 2009. The change was primarily driven by the following factors:

- A decrease of \$183.2 million in cash proceeds from the sale of our common stock. During fiscal 2009, we sold 17.4 million shares of our common stock, together with warrants to purchase an additional 3.9 million shares of our common stock, for net proceeds of \$175.1 million;
- An increase of \$11.0 million in cash payments to net share settle employee equity awards, due to an increase in the number of shares vested and an increase in the intrinsic value of the shares vested as a result of the overall increase in our stock price in fiscal 2010 as compared to fiscal 2009; and
- An increase of \$9.7 million in cash proceeds from the issuance of common stock upon exercise of employee stock options and pursuant to our employee stock purchase plan.

### **Credit Facilities and Debt**

#### ***2.75% Convertible Debentures***

We have \$250 million of 2.75% convertible senior debentures due in 2027 (“the 2027 Debentures”) that were issued on August 13, 2007 in a private placement to Citigroup Global Markets Inc. and Goldman, Sachs & Co. The 2027 Debentures bear an interest rate of 2.75% per annum, payable semi-annually in arrears beginning on February 15, 2008, and mature on August 15, 2027 subject to the right of the holders of the 2027 Debentures to require us to redeem the 2027 Debentures on August 15, 2014, 2017 and 2022. The related debt discount and debt issuance costs are being amortized to interest expense using the effective interest rate method through August 2014. The 2027 Debentures are general senior unsecured obligations, ranking equally in right of payment to all of our existing and future unsecured, unsubordinated indebtedness and senior in right of payment to any indebtedness that is contractually subordinated to the 2027 Debentures. The 2027 Debentures are effectively subordinated to our secured indebtedness to the extent of the value of the collateral securing such indebtedness and are structurally subordinated to indebtedness and other liabilities of our subsidiaries. If converted, the principal amount of the 2027 Debentures is payable in cash and any amounts payable in excess of the \$250 million principal amount, will (based on an initial conversion rate, which represents an initial conversion price of \$19.47 per share, subject to adjustment as defined therein) be paid in cash or shares of our common stock, at our election, only in the following circumstances and to the following extent: (i) on any date during any fiscal quarter beginning after September 30, 2007 (and only during such fiscal quarter) if the closing sale price of our common stock was more than 120% 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) during the five consecutive business-day period following any five consecutive trading-day period in which the trading price for \$1,000 principal amount of the 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; (iii) upon the occurrence of specified corporate transactions, as described in the indenture for the 2027 Debentures; and (iv) at the option of the holder at any time on or after February 15, 2027. Additionally, we may redeem the 2027 Debentures, in whole or in part, on or after August 20, 2014 at par plus accrued and unpaid interest; each holder shall have the right, at such holder’s option, to require us to repurchase all or any portion of the 2027 Debentures held by such holder on August 15, 2014, August 15, 2017 and August 15, 2022. Upon conversion, we will pay the principal amount in cash and any amounts payable in excess of the \$250 million principal amount will be paid in cash or shares of our common stock, at our election. If we undergo a fundamental change (as described in the indenture for the 2027 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 debentures to be purchased plus any accrued and unpaid interest, including any additional interest to, but excluding, the repurchase date. As of September 30, 2010, no conversion triggers were met. If the conversion triggers were met, we could be required to repay all or some of the principal amount in cash prior to the maturity date.

**Credit Facility**

We have a credit facility which consists of a \$75 million revolving credit line including letters of credit, a \$355 million term loan entered into on March 31, 2006, a \$90 million term loan entered into on April 5, 2007 and a \$225 million term loan entered into on August 24, 2007 (the “Credit Facility”). In July 2011, we entered into agreements to amend and restate our existing Credit Facility. Of the approximately \$638.5 million remaining term loan, lenders representing \$493.2 million elected to extend the maturity date by three years to March 31, 2016. The remaining \$145.3 million in term loans are due March 2013. In addition, lenders participating in the revolving credit facility have chosen to extend the maturity date by three years to March 31, 2015. As of September 30, 2011, \$636.9 million remained outstanding under the term loans, there were \$15.4 million of letters of credit issued under the revolving credit line and there were no other outstanding borrowings under the revolving credit line.

The Credit Facility contains covenants, including, among other things, covenants that restrict our ability and those of our subsidiaries to incur certain additional indebtedness, create or permit liens on assets, enter into sale-leaseback transactions, make loans or investments, sell assets, make certain acquisitions, pay dividends, or repurchase stock. The agreement also contains events of default, including failure to make payments of principal or interest, failure to observe covenants, breaches of representations and warranties, defaults under certain other material indebtedness, failure to satisfy material judgments, a change of control and certain insolvency events. As of September 30, 2011, we were in compliance with the covenants under the Credit Facility.

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

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

- (a) The margin is determined based on our leverage ratio and credit rating at the date the interest rates are reset on the Term Loans.
- (b) The margin is determined based on our leverage ratio and credit rating at the date the interest rates are reset on the Revolving credit line.

At September 30, 2011 the applicable margins were 1.75%, with an effective rate of 1.98%, on the remaining balance of \$145.0 maturing in March 2013 and 3.00%, with an effective rate of 3.23%, on the remaining balance of \$492.0 maturing in March 2016. We are required to pay a commitment fee for unutilized commitments under the revolving credit facility at a rate ranging from 0.375% to 0.50% per annum, based upon our leverage ratio. As of September 30, 2011, the commitment fee rate was 0.375%.

We capitalized debt issuance costs related to the Credit Facility and are amortizing the costs to interest expense using the effective interest rate method through March 2013 for costs associated with the unextended portion of the term loan, through March 2015 for costs associated with the revolving credit facility and March 2016 for the remainder of the balance. As of September 30, 2011 and 2010, the ending unamortized deferred financing fees were \$5.8 million and \$5.8 million, respectively, and are included in other assets in the accompanying consolidated balance sheet.

The Credit Facility amendment extended the payment terms on a portion of the loan. Principal is due in quarterly installments of 0.25% of the then outstanding balance through the original maturity date of March 2013 for \$145.3 million, representing the portion of the loan that was not extended. Principal payments on the extended loan of \$493.2 are due in quarterly installments of 0.25% of the then outstanding balance through March 2016, at which point the remaining balance becomes due. In addition, an annual excess cash flow sweep, as defined in the Credit Facility, is payable in the first quarter of each fiscal year, based on the excess cash flow generated in the previous fiscal year. We have not generated excess cash flows in any period and no additional payments are required. We will continue to

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evaluate the extent to which a payment is due in the first quarter of future fiscal years based on excess cash flow generation. At the current time, we are unable to predict the amount of the outstanding principal, if any, that may be required to be repaid in future fiscal years pursuant to the excess cash flow sweep provisions. Any term loan borrowings not paid through the baseline repayment, the excess cash flow sweep, or any other mandatory or optional payments that we may make, will be repaid upon maturity. If only the baseline repayments are made, the annual aggregate principal amount of the term loans repaid would be as follows (dollars in thousands):

| <u>Year Ending September 30,</u> | <u>Amount</u>    |
|----------------------------------|------------------|
| 2012                             | \$ 6,346         |
| 2013                             | 148,385          |
| 2014                             | 4,804            |
| 2015                             | 4,756            |
| 2016                             | 472,650          |
| Total                            | <u>\$636,941</u> |

Our obligations under the Credit Facility are unconditionally guaranteed by, subject to certain exceptions, each of our existing and future direct and indirect wholly-owned domestic subsidiaries. The Credit Facility and the guarantees thereof are secured by first priority liens and security interests in the following: 100% of the capital stock of substantially all of our domestic subsidiaries and 65% of the outstanding voting equity interests and 100% of the non-voting equity interests of first-tier foreign subsidiaries, all our material tangible and intangible assets and those of the guarantors, and any present and future intercompany debt. The Credit Facility also contains provisions for mandatory prepayments of outstanding term loans upon receipt of the following, and subject to certain exceptions: 100% of net cash proceeds from asset sales, 100% of net cash proceeds from issuance or incurrence of debt, and 100% of extraordinary receipts. We may voluntarily prepay borrowings under the Credit Facility without premium or penalty other than breakage costs, as defined with respect to LIBOR-based loans.

The 2027 Debentures provide the holders with the right to convert the debt to shares of our common stock under certain specified conditions, including triggers related to our share price. If the closing share price of our stock exceeds 120% of the initial conversion price of approximately \$19.47 for the periods defined in the agreement, the holders have the right to convert the debentures. Our stock price has been trading above \$23.00 per share for extended periods beginning in October 2011, and therefore it is possible that the holders of the 2027 Debentures will have the right to convert their holdings at some point during fiscal 2012. If the holders make this election, the principal amount of the 2027 Debentures is payable in cash and any amounts payable in excess of the \$250 million principal amount will be paid in cash or shares of our common stock, at our election. Given that the debentures are traded in a secondary market and the current market value of the 2027 Debentures exceeds the value that the holders would receive upon conversion, we believe that the holders may not have a significant economic incentive to exercise their conversion option prior to August 2014.

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

**Off-Balance Sheet Arrangements, Contractual Obligations, Contingent Liabilities and Commitments**

**Contractual Obligations**

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

| Contractual Obligations  | Payments Due by Fiscal Year Ended September 30, |                |                  |                  |                |
|--|---|----------------|------------------|------------------|----------------|
|  | Total   | 2012           | 2013<br>and 2014 | 2015<br>and 2016 | Thereafter     |
| Credit Facility(1)   | \$ 636.9  | \$ 6.3         | \$ 153.2         | \$ 477.4         | \$ —           |
| 2.75% Convertible Senior Debentures(2)   | 250.0   | —              | 250.0            | —                | —              |
| Interest payable under Credit Facility(1)  | 74.3  | 18.7           | 32.6             | 23.0             | —              |
| Interest payable under 2.75% Convertible Senior Debentures(3)  | 20.7  | 6.9            | 13.8             | —                | —              |
| Letter of Credit(4)  | 6.8   | 6.8            | —                | —                | —              |
| Lease obligations and other liabilities:   |   |                |                  |                  |                |
| Operating leases   | 129.4   | 26.5           | 43.7             | 33.9             | 25.3           |
| Other lease obligations associated with the closing of duplicate facilities related to restructurings and acquisitions | 1.6   | 1.3            | 0.3              | —                | —              |
| Pension, minimum funding requirement(5)  | 4.5   | 1.8            | 2.7              | —                | —              |
| Purchase Commitments(6)  | 4.9   | 4.9            | —                | —                | —              |
| Collaboration agreements(7)  | 54.3  | 23.4           | 28.4             | 2.5              | —              |
| Other long-term liabilities assumed(8)   | 21.0  | 12.5           | 5.0              | 3.5              | —              |
| <b>Total contractual cash obligations</b>  | <b>\$1,204.4</b>                                | <b>\$109.1</b> | <b>\$529.7</b>   | <b>\$ 540.3</b>  | <b>\$ 25.3</b> |

- (1) Interest is due and payable monthly under the Credit Facility, and principal is paid on a quarterly basis. The amounts included as interest payable in this table are based on the effective interest rate as of September 30, 2011 related to the Credit Facility.
- (2) Holders of the 2.75% Senior Convertible Debentures have the right to require us to repurchase the debentures on August 15, 2014, 2017 and 2022.
- (3) Interest is due and payable semi-annually under the 2.75% convertible senior debentures.
- (4) We have placed EUR 5.0 million (\$6.8 million based on the September 30, 2011 exchange rate) in an irrevocable standby letter of credit account for payment of a fixed obligation assumed in connection with our acquisition of SpinVox.
- (5) Our U.K. pension plan has a minimum annual funding requirement of £859,900 (approximately \$1.3 million based on the exchange rate at September 30, 2011) for each of the next 3 years, through fiscal 2014.
- (6) These amounts include non-cancelable purchase commitments for inventory in the normal course of business to fulfill customers' orders currently scheduled in our backlog.
- (7) Payments under the research collaboration agreements are payable in cash or common stock at our option.
- (8) Obligations include assumed long-term liabilities relating to restructuring programs initiated by the predecessor companies prior to our acquisition of SpeechWorks International, Inc. in August 2003, and our acquisition of Former Nuance in September 2005. These restructuring programs related to the closing of two facilities with lease terms set to expire in 2016 and 2012, respectively. Total contractual obligations under these two leases are \$21.0 million. As of September 30, 2011, we have sub-leased certain of the office space related to these two facilities to unrelated third parties. Total sublease income under contractual terms is expected to be \$8.3 million, which ranges from \$1.5 million to \$3.0 million on an annualized basis through 2016.

The gross liability for unrecognized tax benefits as of September 30, 2011 was \$14.9 million. We do not expect a significant change in the amount of unrecognized tax benefits within the next 12 months. We estimate that none of

this amount will be paid within the next year and we are currently unable to reasonably estimate the timing of payments for the remainder of the liability.

### **Contingent Liabilities and Commitments**

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

In connection with our acquisition of SNAPin Software, Inc. (“SNAPin”), we agreed to make a contingent earn-out payment of up to \$45.0 million in cash to be paid, if at all, based on the business achieving certain performance targets that are measurable from the acquisition date to December 31, 2009. In April 2010, the Company and the former shareholders of SNAPin agreed on a final earn-out payment of \$21.2 million and we issued 593,676 shares of our common stock, valued at \$10.2 million, as our first payment under the earn-out agreement. The remaining balance of \$11.0 million was paid in cash in October, 2011 and is included in short-term liabilities as of September 30, 2011.

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

### ***Financial Instruments***

We use financial instruments to manage our foreign exchange risk. We follow Financial Accounting Standards Board Accounting Standards Codification 815 (“ASC 815”), *Derivatives and Hedging*, for our derivative instruments.

We operate our business in countries throughout the world and transact business in various foreign currencies. Our foreign currency exposures typically arise from transactions denominated in currencies other than the local functional currency of our operations. During fiscal 2011, we commenced a program that primarily utilizes foreign currency forward contracts to offset the risks associated with foreign currency denominated assets and liabilities. We established this program so that gains and losses from remeasurement or settlement of these assets and liabilities are offset by gains or losses on the foreign currency forward contracts thus mitigating the risks and volatility associated with our foreign currency transactions. Generally, we enter into contracts with terms of 90 days or less, and at September 30, 2011 we had outstanding contracts with a total notional value of \$75.7 million.

From time to time we will enter into agreements that allow us to issue shares of our common stock as part or all of the consideration related to partnering and technology acquisition activities. Generally these shares are issued subject to security price guarantees which are accounted for as derivatives. We have determined that these instruments would not be considered equity instruments if they were freestanding. The security price guarantees require payment from either us to the third party, or from the third party to us, based upon the difference between the price of our common stock on the issue date and an average price of our common stock approximately six months following the issue date. Changes in the fair value of these security price guarantees are reported in earnings in each period as non-operating income (expense) with other income, net. During the year ended September 30, 2011 and 2010, we recorded \$13.2 million and \$4.0 million, respectively of gains associated with these contracts and received cash payments totaling \$9.4 million and \$7.3 million, respectively, upon to settlement of the agreements during the year.

### **Pension Plans**

We assumed the assets and obligations related to certain defined benefit pension plans in connection with our acquisition of Dictaphone, which provide certain retirement and death benefits for former Dictaphone employees located in the United Kingdom and Canada. These two pension plans are closed to new participants. These plans

require periodic cash contributions. The Canadian plan is fully funded and expected to remain fully funded during fiscal 2012, without additional funding. In fiscal 2011, total cash funding for the UK pension plan was \$1.4 million. For the UK pension plan, we have a minimum funding requirement of £859,900 (approximately \$1.3 million based on the exchange rate at September 30, 2011) for each of the next three years, through fiscal 2014.

In connection with our acquisition of SVOX A.G. in June 2011, we assumed an additional defined benefit pension plan for employees in Switzerland. At the end of September, 2011, the plan benefit obligations exceed the plan assets by approximately \$1.9 million. The plan requires periodic cash contributions, including participant contributions from active employees. Company contributions in fiscal 2012 are expected to be \$0.5 million.

#### **Off-Balance Sheet Arrangements**

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

### **CRITICAL ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATES**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. On an ongoing basis, we evaluate our estimates, assumptions and judgments, including those related to revenue recognition; allowance for doubtful accounts and returns; the valuation of goodwill, intangible assets and tangible long-lived assets; accounting for business combinations; accounting for stock-based compensation; accounting for derivative instruments; accounting for income taxes and related valuation allowances; and loss contingencies. Our management bases its estimates on historical experience, market participant fair value considerations and various other factors that are believed to be reasonable under the circumstances. Actual results could differ from these estimates.

We believe the following critical accounting policies most significantly affect the portrayal of our financial condition and results of operations and require our most difficult and subjective judgments.

*Revenue Recognition.* We derive revenue from the following sources: (1) software license agreements, including royalty and other usage-based arrangements, (2) post-contract customer support, (3) fixed and variable fee hosting arrangements and (4) professional services. Our revenue recognition policies for these revenue streams are discussed below.

The sale and/or license of software products and technology is deemed to have occurred when a customer either has taken possession of the related software or technology or has access to take immediate possession of the software or technology. In select situations, we sell or license intellectual property in conjunction with, or in place of, embedding our intellectual property in software. We recognize revenue from the sale or license of software products and licensing of technology when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable and (iv) collectibility is probable. Vendor-specific objective evidence ("VSOE") of fair value for software and software-related services exists when a company can support what the fair value of its software and/or software-related services is based on evidence of the prices charged by the company when the same elements are sold separately. VSOE of fair value is required, generally, in order to separate the accounting for various elements in a software and related services arrangement. We have, in general, established VSOE of fair value of our post-contract customer support ("PCS"), professional services, and training.

Revenue from royalties on sales of our software products by original equipment manufacturers ("OEMs"), where no services are included, is recognized in the quarter earned so long as we have been notified by the OEM that such royalties are due, and provided that all other revenue recognition criteria are met.

Software arrangements generally include PCS, which includes telephone support and the right to receive unspecified upgrades/enhancements on a when-and-if-available basis, typically for one to five years. Revenue from PCS is recognized ratably on a straight-line basis over the term that the maintenance service is provided.

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Non-software revenue, such as arrangements containing hosting services where the customer does not take possession of the software at the outset of the arrangement and has no contractual right to do so, is recognized when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the fees are fixed or determinable and (iv) collectibility is reasonably assured.

For revenue arrangements with multiple elements that are not considered to be software or software-related, we allocate an arrangement's fees into separate units of accounting based on fair value. We generally support fair value of our deliverables based upon the prices we charge when we sell similar elements separately.

Revenue from products offered on a subscription and/or hosted, on-demand basis is recognized in the period the services are provided, based on a fixed minimum fee and/or variable fees based on the volume of activity. Variable subscription and hosting revenue is recognized as we are notified by the customer or through management reports that such revenue is due, provided that all other revenue recognition criteria are met.

Set-up fees from arrangements containing hosting services, as well as the associated direct and incremental costs, are deferred and recognized ratably over the longer of the contractual lives, or the expected lives of the customer relationships.

When we provide professional services considered essential to the functionality of the software, we recognize revenue from the professional services as well as any related software licenses on a percentage-of-completion basis whereby the arrangement consideration is recognized as the services are performed as measured by an observable input. In these circumstances, we separate license revenue from professional service revenue for income statement presentation by allocating VSOE of fair value of the professional services as professional service revenue and the residual portion as license revenue. We generally determine the percentage-of-completion by comparing the labor hours incurred to-date to the estimated total labor hours required to complete the project. We consider labor hours to be the most reliable, available measure of progress on these projects. Adjustments to estimates to complete are made in the periods in which facts resulting in a change become known. When the estimate indicates that a loss will be incurred, such loss is recorded in the period identified. Significant judgments and estimates are involved in determining the percent complete of each contract. Different assumptions could yield materially different results.

When products are sold through distributors or resellers, title and risk of loss generally passes upon shipment, at which time the transaction is invoiced and payment is due. Shipments to distributors and resellers without right of return are recognized as revenue upon shipment, provided all other revenue recognition criteria are met. Certain distributors and value-added resellers have been granted rights of return for as long as the distributors or resellers hold the inventory. We cannot estimate historical returns from these distributors and resellers; and therefore, cannot use such estimates as the basis upon which to estimate future sales returns. As a result, we recognize revenue from sales to these distributors and resellers when the products are sold through to retailers and end-users.

When products are sold directly to retailers or end-users, we make an estimate of sales returns based on historical experience. The provision for these estimated returns is recorded as a reduction of revenue and accounts receivable at the time that the related revenue is recorded. If actual returns differ significantly from our estimates, such differences could have a material impact on our results of operations for the period in which the actual returns become known.

When maintenance and support contracts renew automatically, we provide a reserve based on historical experience for contracts expected to be cancelled for non-payment. All known and estimated cancellations are recorded as a reduction to revenue and accounts receivable.

We record consideration given to a reseller as a reduction of revenue to the extent we have recorded cumulative revenue from the customer or reseller. However, when we receive an identifiable benefit in exchange for the consideration, and can reasonably estimate the fair value of the benefit received, the consideration is recorded as an operating expense.

We record reimbursements received for out-of-pocket expenses as revenue, with offsetting costs recorded as cost of revenue. Out-of-pocket expenses generally include, but are not limited to, expenses related to transportation, lodging and meals.

We record shipping and handling costs billed to customers as revenue with offsetting costs recorded as cost of revenue.

Our revenue recognition policies require management to make significant estimates. Management analyzes various factors, including a review of specific transactions, historical experience, creditworthiness of customers and current market and economic conditions. Changes in judgments based upon these factors could impact the timing and amount of revenue and cost recognized and thus affects our results of operations and financial condition.

*Business Combinations.* We determine and allocate the purchase price of an acquired company to the tangible and intangible assets acquired and liabilities assumed as of the business combination date. The purchase price allocation process requires us to use significant estimates and assumptions, including fair value estimates, as of the business acquisition date, including:

- estimated fair values of intangible assets;
- estimated fair market values of legal performance commitments to customers, assumed from the acquiree under existing contractual obligations (classified as deferred revenue) at the date of acquisition;
- estimated fair market values of stock awards assumed from the acquiree that are included in the purchase price;
- estimated fair market value of required payments under contingent consideration provisions;
- estimated income tax assets and liabilities assumed from the acquiree; and
- estimated fair value of pre-acquisition contingencies assumed from the acquiree.

While we use our best estimates and assumptions as a part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the business combination date, our estimates and assumptions are inherently uncertain and subject to refinement. As a result, during the purchase price allocation period, which is generally one year from the business combination date, we record adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill. Subsequent to the purchase price allocation period any adjustment to assets acquired or liabilities assumed is included in operating results in the period in which the adjustment is determined. For changes in the valuation of intangible assets between preliminary and final purchase price allocation, the related amortization is adjusted on a prospective basis.

Although we believe the assumptions and estimates we have made in the past have been reasonable and appropriate, they are based in part on historical experience and information obtained from the management of the acquired companies and are inherently uncertain. Examples of critical estimates in valuing certain of the intangible assets we have acquired or may acquire in the future include but are not limited to:

- future expected cash flows from software license sales, support agreements, consulting contracts, other customer contracts and acquired developed technologies and patents;
- expected costs to develop in-process research and development projects into commercially viable products and the estimated cash flows from the projects when completed;
- the acquired company's brand and competitive position, as well as assumptions about the period of time the acquired brand will continue to be used in the combined company's product portfolio; and
- discount rates.

Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates or actual results.

In connection with the purchase price allocations for our acquisitions, we estimate the fair market value of legal performance commitments to customers, which are classified as deferred revenue. The estimated fair market value of these obligations is determined and recorded as of the acquisition date.

For a given acquisition, we may identify certain pre-acquisition contingencies. If, during the purchase price allocation period, we are able to determine the fair value of a pre-acquisition contingency, we will include that



amount in the purchase price allocation. If we are unable to determine the fair value of a pre-acquisition contingency at the end of the purchase price allocation period, we will evaluate whether to include an amount in the purchase price allocation based on whether it is probable a liability had been incurred and whether an amount can be reasonably estimated. After the end of the purchase price allocation period, any adjustment to amounts recorded for a pre-acquisition contingency will be included in our operating results in the period in which the adjustment is determined.

*Goodwill, Intangible and Other Long-Lived Assets and Impairment Assessments.* We have significant long-lived tangible and intangible assets, including goodwill and intangible assets with indefinite lives, which are susceptible to valuation adjustments as a result of changes in various factors or conditions. The most significant finite-lived tangible and intangible assets are customer relationships, licensed technology, patents and core technology, completed technology, fixed assets and trade names. All finite-lived intangible assets are amortized based upon patterns in which the economic benefits are expected to be utilized. The values of intangible assets determined in connection with a business combination, with the exception of goodwill, were initially determined by a risk-adjusted, discounted cash flow approach. We assess the potential impairment of intangible and fixed assets whenever events or changes in circumstances indicate that the carrying values may not be recoverable. Goodwill and indefinite-lived intangible assets are assessed for potential impairment at least annually, but also whenever events or changes in circumstances indicate the carrying values may not be recoverable. Factors we consider important, which could trigger an impairment of such assets, include the following:

- significant underperformance relative to historical or projected future operating results;
- significant changes in the manner of or use of the acquired assets or the strategy for our overall business;
- significant negative industry or economic trends;
- significant decline in our stock price for a sustained period; and
- a decline in our market capitalization below net book value.

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

We test goodwill and intangible assets with indefinite lives for impairment annually in the fourth quarter, and between annual tests if indicators of potential impairment exist. The impairment test for goodwill and intangible assets with indefinite lives compares the fair value of identified reporting unit(s) to its (their) carrying amount to assess whether such assets are impaired. As a result of the change in our reportable segments in fiscal 2011, we now have seven reporting units based on the level of information provided to, and review thereof, by our management.

We determine fair values for each of the reporting units using an income approach. When available and appropriate, we also use a comparative market approach to derive the fair values. For purposes of the income approach, fair value is determined based on the present value of estimated future cash flows, discounted at an appropriate risk adjusted rate. We use our internal forecasts to estimate future cash flows and include an estimate of long-term future growth rates based on our most recent views of the long-term outlook for each business. Actual results may differ from those assumed in our forecasts. We derive our discount rates using a capital asset pricing model and analyzing published rates for industries relevant to our reporting units to estimate the cost of equity financing. We use discount rates that are commensurate with the risks and uncertainty inherent in the respective businesses and in our internally developed forecasts. Discount rates used in our reporting unit valuations ranged from 13% to 23%. For purposes of the market approach, we use a valuation technique in which values are derived based on market prices of comparable publicly traded companies. We also use a market based valuation technique in which values are determined based on relevant observable information generated by market transactions involving comparable businesses. Compared to the market approach, the income approach more closely aligns each reporting unit valuation to our business profile, including geographic markets served and product offerings. Required rates of return, along with uncertainty inherent in the forecasts of future cash flows, are reflected in the selection of the discount rate. Equally important, under this approach, reasonably likely scenarios and associated sensitivities can be developed for alternative future states that may not be reflected in an observable market price. A market approach allows for comparison to actual market transactions and multiples. It can be somewhat more limited in its

application because the population of potential comparables is often limited to publicly-traded companies where the characteristics of the comparative business and ours can be significantly different, market data is usually not available for divisions within larger conglomerates or non-public subsidiaries that could otherwise qualify as comparable, and the specific circumstances surrounding a market transaction (e.g., synergies between the parties, terms and conditions of the transaction, etc.) may be different or irrelevant with respect to our business. It can also be difficult, under certain market conditions, to identify orderly transactions between market participants in similar businesses. We assess each valuation methodology based upon the relevance and availability of the data at the time we perform the valuation and weight the methodologies appropriately.

The carrying values of the reporting units were determined based on an allocation of our assets and liabilities through specific allocation of certain assets and liabilities, to the reporting units and an apportionment method based on relative size of the reporting units' revenues and operating expenses compared to the Company as a whole. Goodwill was allocated to the new reporting units based on the relative fair value of the affected units at the date we implemented the new structure. Certain corporate assets that are not instrumental to the reporting units' operations and would not be transferred to hypothetical purchasers of the reporting units were excluded from the reporting units' carrying values.

Based on our assessments, we have not had any impairment charges during our history as a result of our impairment evaluation of goodwill. Significant adverse changes in our future revenues and/or adjusted EBITDA results, or significant degradation in the enterprise values of comparable companies within our segments, could result in the determination that all or a portion of our goodwill is impaired. However, as of our fiscal 2011 annual impairment assessment date, our estimated fair values of our reporting units significantly exceeded their carrying values.

We periodically review long-lived assets other than goodwill or indefinite-lived intangible assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives of those assets are no longer appropriate. Each impairment test is based on a comparison of the undiscounted cash flows to the recorded carrying value for the asset or asset group. Asset groups utilized in this analysis are identified as the lowest level grouping of assets for which largely independent cash flows can be identified. If impairment is indicated, the asset or asset group is written down to its estimated fair value.

Significant judgments and estimates are involved in determining the useful lives of our long-lived assets, determining the reporting units and assessing when events or circumstances would require an interim impairment analysis of goodwill or other long-lived assets to be performed. Changes in our organization or management reporting structure, as well as other events and circumstances, including but not limited to technological advances, increased competition and changing economic or market conditions, could result in (a) shorter estimated useful lives, (b) changes to reporting units, which may require alternative methods of estimating fair values or greater disaggregation or aggregation in our analysis by reporting unit, and/or (c) other changes in previous assumptions or estimates. In turn, this could have a significant impact on our consolidated financial statements through accelerated amortization and/or impairment charges.

*Accounting for Stock-Based Compensation.* We account for share-based awards to employees and directors, including grants of employee stock options, purchases under employee stock purchase plans, awards in the form of restricted shares ("Restricted Stock") and awards in the form of units of stock purchase rights ("Restricted Units") through recognition of the fair value of the share-based awards as a charge against earnings in the form of stock-based compensation expense. We recognize stock-based compensation expense over the requisite service period, net of estimated forfeitures. We will recognize a benefit from stock-based compensation in equity using the with-and-without approach for the utilization of tax attributes. The Restricted Stock and Restricted Units are collectively referred to as "Restricted Awards." Determining the fair value of share-based awards at the grant date requires judgment, including estimating expected dividends, share price volatility and the amount of share-based awards that are expected to be forfeited. If actual results differ significantly from these estimates, stock-based compensation expense and our results of operations could be materially impacted.

*Income Taxes.* Deferred tax assets and liabilities are determined based on differences between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences

are expected to reverse. We do not provide for U.S. income taxes on the undistributed earnings of our foreign subsidiaries, which we consider to be indefinitely reinvested outside of the U.S.

We make judgments regarding the realizability of our deferred tax assets. The balance sheet carrying value of our net deferred tax assets is based on whether we believe that it is more likely than not that we will generate sufficient future taxable income to realize these deferred tax assets after consideration of all available evidence. We regularly review our deferred tax assets for recoverability considering historical profitability, projected future taxable income, and the expected timing of the reversals of existing temporary differences and tax planning strategies.

Valuation allowances have been established for U.S. and certain foreign deferred tax assets, which we believe do not meet the “more likely than not” criteria for recognition. If we are subsequently able to utilize all or a portion of the deferred tax assets for which a valuation allowance has been established, then we may be required to recognize these deferred tax assets through the reduction of the valuation allowance which could result in a material benefit to our results of operations in the period in which the benefit is determined, excluding the recognition of the portion of the valuation allowance which relates to net deferred tax assets created as a result of stock-based compensation or other equity transactions where prevailing guidance requires the change in valuation allowance to be traced forward. The recognition of the portion of the valuation allowance which relates to net deferred tax assets resulting from stock-based compensation or other qualifying equity transactions will be recorded as additional paid-in-capital.

We establish reserves for tax uncertainties that reflect the use of the comprehensive model for the recognition and measurement of uncertain tax positions. Under the comprehensive model, when the minimum threshold for recognition is not met, no tax benefit can be recorded. When the minimum threshold for recognition is met, a tax position is recorded as the largest amount that is more than fifty percent likely of being realized upon ultimate settlement.

*Loss Contingencies.* We are subject to legal proceedings, lawsuits and other claims relating to labor, service and other matters arising in the ordinary course of business, as discussed in Note 18 of Notes to our Consolidated Financial Statements. Quarterly, we review the status of each significant matter and assess our potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount can be reasonably estimated, we accrue a liability for the estimated loss. Significant judgment is required in both the determination of probability and the determination as to whether an exposure is reasonably estimable. Because of uncertainties related to these matters, accruals are based only on the best information available at the time. As additional information becomes available, we reassess the potential liability related to our pending claims and litigation and may revise our estimates. Such revisions in the estimates of the potential liabilities could have a material impact on our results of operations and financial position.

#### **RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

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

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards*, to provide consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements, particularly for level 3 fair value measurements (as defined in Note 12 of Notes to our Consolidated Financial Statements). ASU 2011-04 is effective for periods beginning after December 15, 2011. We are currently evaluating the impact on our fair value measures.

In December 2010, the FASB issued ASU No. 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations*, to provide guidelines for how pro forma disclosures are calculated. In addition, ASU 2010-29 expands the disclosure requirements and requires a description of the nature and amount of any material, nonrecurring pro forma adjustments directly attributable to a business combination and is effective for fiscal years beginning after December 15, 2010. ASU 2010-29 impacts disclosure only and therefore, did not, and is not expected to have a material impact on our financial statements.

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

In January 2010, the FASB issued Accounting Standards Update No. 2010-06, *Improving Disclosures about Fair Value Measurements (Topic 820) — Fair Value Measurements and Disclosures* (“ASU 2010-06”), which requires additional disclosures about the different classes of assets and liabilities measured at fair value, the valuation techniques and inputs used, the activity in Level 3 fair value measurements, and transfers between Levels 1, 2, and 3. Levels 1, 2 and 3 of fair value measurements are defined in Note 12 of Notes to our Consolidated Financial Statements. ASU 2010-06 was effective for us for the interim reporting period beginning January 1, 2010, except for the provisions related to activity in Level 3 fair value measurements. Those provisions are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. ASU 2010-06 impacts disclosure only and therefore, did not, and is not expected to, have a material impact on our financial statements.

#### **Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

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

#### **Exchange Rate Sensitivity**

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

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

Periodically, we enter into forward exchange contracts to hedge against foreign currency fluctuations. These contracts may or may not be designated as cash flow hedges for accounting purposes. At September 30, 2011, we have foreign currency contracts with a total notional value of approximately \$0.5 million designated as cash flow hedges. These contracts all mature in October 2011. The notional contract amount of outstanding foreign currency exchange contracts not designated as cash flow hedges was \$75.7 million at September 30, 2011. During fiscal 2011 and 2010, we recorded foreign exchange loss of (\$1.1) million and a gain of \$3.5 million, respectively. Based on the nature of the transaction for which the contracts were purchased, a hypothetical change of 10% in exchange rates would not have a material impact on our financial results.

### **Interest Rate Sensitivity**

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

At September 30, 2011, we held approximately \$447.2 million of cash and cash equivalents primarily consisting of cash and money-market funds. Due to the low current market yields and the short-term nature of our investments, a hypothetical change in market rates of one percentage point would not have a material effect on the fair value of our portfolio or results of operations.

At September 30, 2011, our total outstanding debt balance exposed to variable interest rates was \$636.9 million. A hypothetical change in market rates would have a significant impact on interest expense and amounts payable. Assuming a one percentage point increase in interest rates, our interest expense relative to our outstanding variable rate debt would increase \$6.4 million per annum.

### **Equity Price Risk**

We are exposed to equity price risk as a result of security price guarantees that we enter in to from time to time. Generally, these price guarantees are for a period of six months or less, and require payment from either us to a third party, or from the third party to us, based upon changes in our stock price during the contract term. As of September 30, 2011, we have security price guarantees outstanding for approximately 1.3 million shares of our common stock. A 10% change in our stock price during the next six months would not have a material impact on our statements of operations or cash flows.

### **Convertible Debentures**

The fair value of our 2.75% convertible debentures due in 2027 is dependent on the price and volatility of our common stock as well as movements in interest rates. The fair market value of the debentures will generally increase or decrease as the market price of our common stock changes. The fair market value of the debentures will generally increase as interest rates fall and decrease as interest rates rise. The market value and interest rate changes affect the fair market value of the debentures, but do not impact our financial position, cash flows or results of operations due to the fixed nature of the debt obligations. However, increases in the value of our common stock above \$23.36 for a specified period of time may provide the holders of the debentures the right to convert each bond using a conversion ratio and payment method as defined in the debenture agreement.

Our debentures trade in the financial markets, and the fair value at September 30, 2011 was \$313.4 million, based on an average of the bid and ask prices for that day. This compares to a conversion value on September 30, 2011 of approximately \$261.2 million. A 10% increase in the stock price over the September 30, 2011 closing price of \$20.34 would have an estimated \$19.7 million increase to the fair value and a \$26.1 million increase to the conversion value of the debentures. Given the current trading value of the debentures, the greatest value to the holders of the debentures would be to sell their holding in the open market in order to maximize their return. Based on this, we believe that the holders may not have a significant economic incentive to convert prior to the first redemption date in August 2014.

## **Item 8. *Financial Statements and Supplementary Data***

### **Nuance Communications, Inc. Consolidated Financial Statements**

NUANCE COMMUNICATIONS, INC.  
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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders  
Nuance Communications, Inc.  
Burlington, Massachusetts

We have audited the accompanying consolidated balance sheets of Nuance Communications, Inc. as of September 30, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the three years in the period ended September 30, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Nuance Communications, Inc. at September 30, 2011 and 2010, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2011, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Nuance Communications, Inc.'s internal control over financial reporting as of September 30, 2011, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations (COSO), and our report dated November 29, 2011 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP  
BDO USA, LLP

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Boston, Massachusetts  
November 29, 2011

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders  
Nuance Communications, Inc.  
Burlington, Massachusetts

We have audited Nuance Communication Inc.'s internal control over financial reporting as of September 30, 2011, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Nuance Communications, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Nuance Communications, Inc. maintained, in all material respects, effective internal control over financial reporting as of September 30, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Nuance Communications, Inc. as of September 30, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the three years in the period ended September 30, 2011 and our report dated November 29, 2011 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP  
BDO USA, LLP

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Boston, Massachusetts  
November 29, 2011



**NUANCE COMMUNICATIONS, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

|  | Year Ended September 30,                 |                    |                    |
|--|--|--------------------|--------------------|
|  | 2011                                     | 2010               | 2009               |
|  | (In thousands, except per share amounts) |                    |                    |
| <b>Revenues:</b>                                   |  |                    |                    |
| Product and licensing                              | \$ 607,358                               | \$ 473,460         | \$ 373,367         |
| Professional services and hosting                  | 509,141                                  | 463,567            | 411,363            |
| Maintenance and support                            | 202,242                                  | 181,921            | 165,622            |
| Total revenues                                     | <u>1,318,741</u>                         | <u>1,118,948</u>   | <u>950,352</u>     |
| <b>Cost of revenues:</b>                           |  |                    |                    |
| Product and licensing                              | 65,601                                   | 49,618             | 37,255             |
| Professional services and hosting                  | 341,055                                  | 280,725            | 254,777            |
| Maintenance and support                            | 38,057                                   | 31,269             | 29,129             |
| Amortization of intangible assets                  | 55,111                                   | 47,758             | 38,390             |
| Total cost of revenues                             | <u>499,824</u>                           | <u>409,370</u>     | <u>359,551</u>     |
| Gross profit                                       | <u>818,917</u>                           | <u>709,578</u>     | <u>590,801</u>     |
| <b>Operating expenses:</b>                         |  |                    |                    |
| Research and development                           | 179,377                                  | 152,071            | 116,774            |
| Sales and marketing                                | 306,439                                  | 266,208            | 217,773            |
| General and administrative                         | 147,603                                  | 122,061            | 100,478            |
| Amortization of intangible assets                  | 88,219                                   | 87,819             | 76,978             |
| Acquisition-related costs, net                     | 21,866                                   | 30,611             | 15,703             |
| Restructuring and other charges, net               | 22,862                                   | 17,891             | 5,520              |
| Total operating expenses                           | <u>766,366</u>                           | <u>676,661</u>     | <u>533,226</u>     |
| Income from operations                             | 52,551                                   | 32,917             | 57,575             |
| <b>Other income (expense):</b>                     |  |                    |                    |
| Interest income                                    | 3,159                                    | 1,238              | 3,562              |
| Interest expense                                   | (36,703)                                 | (40,993)           | (47,288)           |
| Other income, net                                  | 11,010                                   | 5,773              | 7,155              |
| Income (loss) before income taxes                  | 30,017                                   | (1,065)            | 21,004             |
| (Benefit) provision for income taxes               | (8,221)                                  | 18,034             | 40,391             |
| Net income (loss)                                  | <u>\$ 38,238</u>                         | <u>\$ (19,099)</u> | <u>\$ (19,387)</u> |
| <b>Net income (loss) per share:</b>                |  |                    |                    |
| Basic  | <u>\$ 0.13</u>                           | <u>\$ (0.07)</u>   | <u>\$ (0.08)</u>   |
| Diluted  | <u>\$ 0.12</u>                           | <u>\$ (0.07)</u>   | <u>\$ (0.08)</u>   |
| <b>Weighted average common shares outstanding:</b> |  |                    |                    |
| Basic  | <u>302,277</u>                           | <u>287,412</u>     | <u>253,644</u>     |
| Diluted  | <u>315,960</u>                           | <u>287,412</u>     | <u>253,644</u>     |

See accompanying notes.

**NUANCE COMMUNICATIONS, INC.**  
**CONSOLIDATED BALANCE SHEETS**

|   | <u>September 30,</u><br><u>2011</u> | <u>September 30,</u><br><u>2010</u> |
|---|-------------------------------------|-------------------------------------|
| <u>(In thousands, except<br/>per share amounts)</u>   |                                     |                                     |
| <b>ASSETS</b>   |                                     |                                     |
| Current assets:   |                                     |                                     |
| Cash and cash equivalents   | \$ 447,224                          | \$ 516,630                          |
| Restricted cash (Note 9)  | 6,799                               | 24,503                              |
| Marketable securities   | 31,244                              | 5,044                               |
| Accounts receivable, less allowances for doubtful accounts of \$5,707 and \$6,301   | 280,186                             | 217,587                             |
| Acquired unbilled accounts receivable   | 670                                 | 7,412                               |
| Prepaid expenses and other current assets   | 88,804                              | 70,466                              |
| Total current assets  | 854,927                             | 841,642                             |
| Land, building and equipment, net   | 78,218                              | 62,083                              |
| Marketable securities   | —                                   | 28,322                              |
| Goodwill  | 2,347,880                           | 2,077,943                           |
| Intangible assets, net  | 731,577                             | 685,865                             |
| Other assets  | 82,691                              | 73,844                              |
| Total assets  | \$ 4,095,293                        | \$ 3,769,699                        |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                     |                                     |
| Current liabilities:  |                                     |                                     |
| Current portion of long-term debt and capital leases  | \$ 6,905                            | \$ 7,764                            |
| Contingent and deferred acquisition payments  | 23,783                              | 2,131                               |
| Accounts payable  | 82,703                              | 78,616                              |
| Accrued expenses and other current liabilities  | 176,074                             | 151,621                             |
| Deferred revenue  | 185,605                             | 142,340                             |
| Total current liabilities   | 475,070                             | 382,472                             |
| Long-term portion of debt and capital leases  | 853,020                             | 851,014                             |
| Deferred revenue, net of current portion  | 90,382                              | 76,598                              |
| Deferred tax liability  | 72,229                              | 63,731                              |
| Other liabilities   | 111,221                             | 98,688                              |
| Total liabilities   | 1,601,922                           | 1,472,503                           |
| Commitments and contingencies (Notes 3, 5, and 18)  |                                     |                                     |
| Stockholders' equity:   |                                     |                                     |
| Series B preferred stock, \$0.001 par value; 15,000 shares authorized; 3,562 shares issued and outstanding (liquidation preference \$4,631) | 4,631                               | 4,631                               |
| Common stock, \$0.001 par value; 560,000 shares authorized; 312,456 and 301,623 shares issued and 308,705 and 297,950 shares outstanding    | 312                                 | 302                                 |
| Additional paid-in capital  | 2,745,931                           | 2,581,901                           |
| Treasury stock, at cost (3,751 and 3,673 shares)  | (16,788)                            | (16,788)                            |
| Accumulated other comprehensive income  | 2,402                               | 8,505                               |
| Accumulated deficit   | (243,117)                           | (281,355)                           |
| Total stockholders' equity  | 2,493,371                           | 2,297,196                           |
| Total liabilities and stockholders' equity  | \$ 4,095,293                        | \$ 3,769,699                        |

See accompanying notes.

NUANCE COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)

|   | Preferred Stock |          | Common Stock |        | Additional<br>Paid-In<br>Capital | Treasury Stock |             | Accumulated<br>Other<br>Comprehensive<br>Income | Accumulated<br>Deficit | Total<br>Stockholders'<br>Equity | Comprehensive<br>Income (Loss) |  |
|---|-----------------|----------|--------------|--------|----------------------------------|----------------|-------------|---|------------------------|----------------------------------|--------------------------------|--|
|   | Shares          | Amount   | Shares       | Amount |                                  | Shares         | Amount      |   |                        |                                  |                                |  |
|   | (In thousands)  |          |              |        |                                  |                |             |   |                        |                                  |                                |  |
| Balance at October 1, 2008  | 3,562           | 4,631    | 232,592      | 232    | 1,712,993                        | 3,222          | (16,070)    | 12,739  | (242,869)              | 1,471,656                        |                                |  |
| Issuance of common stock under employee stock-based compensation plans                                |                 |          | 3,722        | 5      | 19,832                           |                |             |   |                        | 19,837                           |                                |  |
| Issuance of restricted stock  |                 |          | 2,945        | 3      | (3)                              |                |             |   |                        | —                                |                                |  |
| Cancellation of restricted stock, and repurchase of common stock at cost for employee tax withholding |                 |          | (886)        | (1)    | (10,401)                         | 15             | (143)       |   |                        | (10,545)                         |                                |  |
| Stock-based compensation  |                 |          |              |        | 71,407                           |                |             |   |                        | 71,407                           |                                |  |
| Excess tax benefit from share-based payment plans   |                 |          |              |        | 733                              |                |             |   |                        | 733                              |                                |  |
| Issuance of common stock in connection with financing, net of expenses                                |                 |          | 17,396       | 17     | 175,029                          |                |             |   |                        | 175,046                          |                                |  |
| Issuance of common stock in connection with warrant exercises, net of issuance costs                  |                 |          | 4,575        | 5      | 20,520                           |                |             |   |                        | 20,525                           |                                |  |
| Issuance of common stock in connection with business and asset acquisitions                           |                 |          | 19,196       | 19     | 268,669                          | 475            | (1)         |   |                        | 268,687                          |                                |  |
| Issuance of common stock to escrow agent in connection with acquisitions                              |                 |          | 1,107        | 1      | (1)                              |                |             |   |                        | —                                |                                |  |
| Vested options for the purchase of common stock, assumed in connection with acquisitions              |                 |          |              |        | 11,523                           |                |             |   |                        | 11,523                           |                                |  |
| Payments for escrow, make-whole and earn-out settlements  |                 |          |              |        | 38,691                           |                |             |   |                        | 38,691                           |                                |  |
| Comprehensive loss:   |                 |          |              |        |                                  |                |             |   |                        |                                  |                                |  |
| Net loss  |                 |          |              |        |                                  |                |             |   | (19,387)               | (19,387)                         | \$ (19,387)                    |  |
| Unrealized losses on cash flow hedge derivatives  |                 |          |              |        |                                  |                |             | (3,103)   |                        | (3,103)                          | (3,103)                        |  |
| Foreign currency translation adjustment   |                 |          |              |        |                                  |                |             | 729   |                        | 729                              | 729                            |  |
| Unrealized losses on pensions   |                 |          |              |        |                                  |                |             | (2,798)   |                        | (2,798)                          | (2,798)                        |  |
| Comprehensive loss  |                 |          |              |        |                                  |                |             |   |                        |                                  | \$ (24,559)                    |  |
| Balance at September 30, 2009   | 3,562           | 4,631    | 280,647      | 281    | 2,308,992                        | 3,712          | (16,214)    | 7,567   | (262,256)              | 2,043,001                        |                                |  |
| Issuance of common stock under employee stock-based compensation plans                                |                 |          | 4,402        | 4      | 29,506                           |                |             |   |                        | 29,510                           |                                |  |
| Issuance of restricted stock  |                 |          | 5,737        | 6      | (6)                              |                |             |   |                        | —                                |                                |  |
| Cancellation of restricted stock, and repurchase of common stock at cost for employee tax withholding |                 |          | (1,635)      | (2)    | (25,973)                         | (39)           | (574)       |   |                        | (26,549)                         |                                |  |
| Stock-based compensation  |                 |          |              |        | 100,139                          |                |             |   |                        | 100,139                          |                                |  |
| Excess tax benefit from share-based payment plans   |                 |          |              |        | 1,060                            |                |             |   |                        | 1,060                            |                                |  |
| Issuance of common stock in connection with warrant exercises, net of issuance costs                  |                 |          | 2,509        | 3      | 12,347                           |                |             |   |                        | 12,350                           |                                |  |
| Issuance of common stock in connection with business and asset acquisitions                           |                 |          | 6,845        | 7      | 106,329                          |                |             |   |                        | 106,336                          |                                |  |
| Issuance of common stock in connection with collaboration agreements                                  |                 |          | 2,524        | 2      | 39,298                           |                |             |   |                        | 39,300                           |                                |  |
| Payments for escrow, make-whole and earn-out settlements  |                 |          | 594          | 1      | 10,209                           |                |             |   |                        | 10,210                           |                                |  |
| Comprehensive loss:   |                 |          |              |        |                                  |                |             |   |                        |                                  |                                |  |
| Net loss  |                 |          |              |        |                                  |                |             |   | (19,099)               | (19,099)                         | \$ (19,099)                    |  |
| Unrealized gains on cash flow hedge derivatives   |                 |          |              |        |                                  |                |             | 4,208   |                        | 4,208                            | 4,208                          |  |
| Unrealized gain on marketable securities  |                 |          |              |        |                                  |                |             | 30  |                        | 30                               | 30                             |  |
| Foreign currency translation adjustment   |                 |          |              |        |                                  |                |             | (2,807)   |                        | (2,807)                          | (2,807)                        |  |
| Unrealized losses on pensions   |                 |          |              |        |                                  |                |             | (493)   |                        | (493)                            | (493)                          |  |
| Comprehensive loss  |                 |          |              |        |                                  |                |             |   |                        |                                  | \$ (18,161)                    |  |
| Balance at September 30, 2010   | 3,562           | 4,631    | 301,623      | 302    | 2,581,901                        | 3,673          | (16,788)    | 8,505   | (281,355)              | 2,297,196                        |                                |  |
| Issuance of common stock under employee stock-based compensation plans                                |                 |          | 4,762        | 5      | 36,662                           |                |             |   |                        | 36,667                           |                                |  |
| Issuance of restricted stock  |                 |          | 6,290        | 6      | (6)                              |                |             |   |                        | —                                |                                |  |
| Cancellation of restricted stock, and repurchase of common stock at cost for employee tax withholding |                 |          | (1,996)      | (2)    | (36,705)                         | 78             | —           |   |                        | (36,707)                         |                                |  |
| Stock-based compensation  |                 |          |              |        | 112,469                          |                |             |   |                        | 112,469                          |                                |  |
| Excess tax benefit from share-based payment plans   |                 |          |              |        | 17,520                           |                |             |   |                        | 17,520                           |                                |  |
| Issuance of common stock in connection with business and asset acquisitions                           |                 |          | 486          | —      | 10,000                           |                |             |   |                        | 10,000                           |                                |  |
| Issuance of common stock in connection with collaboration agreements                                  |                 |          | 1,274        | 1      | 23,399                           |                |             |   |                        | 23,400                           |                                |  |
| Payments for escrow, make-whole and earn-out settlements  |                 |          | 17           | —      | 691                              |                |             |   |                        | 691                              |                                |  |
| Comprehensive income:   |                 |          |              |        |                                  |                |             |   |                        |                                  |                                |  |
| Net income  |                 |          |              |        |                                  |                |             |   | 38,238                 | 38,238                           | \$ 38,238                      |  |
| Unrealized losses on cash flow hedge derivatives  |                 |          |              |        |                                  |                |             | (210)   |                        | (210)                            | (210)                          |  |
| Unrealized losses on marketable securities  |                 |          |              |        |                                  |                |             | (42)  |                        | (42)                             | (42)                           |  |
| Foreign currency translation adjustment   |                 |          |              |        |                                  |                |             | (8,746)   |                        | (8,746)                          | (8,746)                        |  |
| Unrealized gains on pensions  |                 |          |              |        |                                  |                |             | 2,895   |                        | 2,895                            | 2,895                          |  |
| Comprehensive income  |                 |          |              |        |                                  |                |             |   |                        |                                  | \$ 32,135                      |  |
| Balance at September 30, 2011   | 3,562           | \$ 4,631 | 312,456      | \$ 312 | \$ 2,745,931                     | 3,751          | \$ (16,788) | \$ 2,402  | \$ (243,117)           | \$ 2,493,371                     |                                |  |

See accompanying notes.

**NUANCE COMMUNICATIONS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

|  | Year Ended September 30, |                   |                   |
|--|--------------------------|-------------------|-------------------|
|  | 2011                     | 2010              | 2009              |
|  | (In thousands)           |                   |                   |
| <b>Cash flows from operating activities</b>  |                          |                   |                   |
| Net income (loss)  | \$ 38,238                | \$ (19,099)       | \$ (19,387)       |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                          |                   |                   |
| Depreciation and amortization  | 170,933                  | 157,156           | 134,059           |
| Stock-based compensation   | 147,296                  | 100,139           | 71,407            |
| Non-cash interest expense  | 12,510                   | 12,955            | 12,492            |
| Non-cash restructuring expense   | 11,725                   | 6,833             | —                 |
| Deferred tax (benefit) provision   | (43,890)                 | 3,742             | 25,718            |
| Other  | 16,492                   | 1,576             | (6,083)           |
| Changes in operating assets and liabilities, net of effects from acquisitions:           |                          |                   |                   |
| Accounts receivable  | (25,530)                 | (773)             | 33,481            |
| Prepaid expenses and other assets  | (11,793)                 | (3,840)           | (14,027)          |
| Accounts payable   | (8,193)                  | 4,710             | 26,582            |
| Accrued expenses and other liabilities   | (6,775)                  | (6,760)           | (5,007)           |
| Deferred revenue   | 56,398                   | 39,643            | (546)             |
| Net cash provided by operating activities  | <u>357,411</u>           | <u>296,282</u>    | <u>258,689</u>    |
| <b>Cash flows from investing activities</b>  |                          |                   |                   |
| Capital expenditures   | (34,907)                 | (25,974)          | (19,512)          |
| Payments for acquisitions, net of cash acquired  | (402,290)                | (203,729)         | (99,120)          |
| Payment for equity investments   | —                        | (14,970)          | (159)             |
| Purchases of marketable securities   | (10,776)                 | (33,529)          | —                 |
| Proceeds from sales and maturities of marketable securities                              | 11,650                   | —                 | 56                |
| Payments for acquired technology   | (6,715)                  | (15,300)          | (65,875)          |
| Change in restricted cash balances   | 17,184                   | (22,070)          | —                 |
| Net cash used in investing activities  | <u>(425,854)</u>         | <u>(315,572)</u>  | <u>(184,610)</u>  |
| <b>Cash flows from financing activities</b>  |                          |                   |                   |
| Payments of debt and capital leases  | (7,535)                  | (8,460)           | (6,999)           |
| Payments of debt issuance costs  | (2,553)                  | —                 | —                 |
| Proceeds from issuance of common stock, net of issuance costs                            | —                        | 12,350            | 195,571           |
| Payments on other long-term liabilities  | (10,643)                 | (9,870)           | (9,180)           |
| Proceeds from settlement of share-based derivatives, net                                 | 9,414                    | 7,306             | —                 |
| Excess tax benefits on employee equity awards  | 17,520                   | 1,060             | 733               |
| Proceeds from issuance of common stock from employee stock plans                         | 36,667                   | 29,510            | 19,837            |
| Cash used to net share settle employee equity awards                                     | (36,908)                 | (22,016)          | (10,546)          |
| Net cash provided by financing activities  | <u>5,962</u>             | <u>9,880</u>      | <u>189,416</u>    |
| Effects of exchange rate changes on cash and cash equivalents                            | (6,925)                  | (998)             | 2,003             |
| Net (decrease) increase in cash and cash equivalents                                     | (69,406)                 | (10,408)          | 265,498           |
| Cash and cash equivalents at beginning of year   | 516,630                  | 527,038           | 261,540           |
| Cash and cash equivalents at end of year   | <u>\$ 447,224</u>        | <u>\$ 516,630</u> | <u>\$ 527,038</u> |

See accompanying notes.

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Organization and Presentation**

Nuance Communications, Inc. (“we,” “Nuance,” or “the Company”) is a leading provider of voice and language solutions for businesses and consumers around the world. Our technologies, applications and services make the user experience more compelling by transforming the way people interact with devices and systems. Our solutions are used for tasks and services such as requesting information from a phone-based self-service solution, dictating medical records, searching the mobile Web by voice, entering a destination into a navigation system, or working with PDF documents. Our solutions help make these interactions, tasks and experiences more productive, compelling and efficient.

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

We have built a portfolio of intellectual property, technologies, applications and solutions through both internal development and acquisitions. We expect to continue to pursue opportunities to expand our assets, geographic presence, distribution network and customer base through acquisitions of other businesses and technologies. Significant business acquisitions during fiscal 2011, 2010 and 2009 were as follows:

- June 16, 2011 — SVOX A.G. (“SVOX”)
- June 15, 2011 — Equitrac Corporation (“Equitrac”)
- December 30, 2009 — SpinVox, Limited (“SpinVox”)
- October 1, 2008 — SNAPin, Inc. (“SNAPin”)

The results of operations from the acquired businesses have been included in our consolidated financial statements from their respective acquisition dates. See Note 3 for additional disclosure related to each of these acquisitions.

As discussed in Note 22, we changed our segment reporting structure in the fourth quarter of fiscal 2011 to four reportable segments; Healthcare, Mobile and Consumer, Enterprise, and Imaging. Prior periods in these consolidated financial statements have been recast to reflect the new segment reporting structure.

**2. Summary of Significant Accounting Policies**

*Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. On an ongoing basis, we evaluate our estimates, assumptions and judgments. The most important of these relate to revenue recognition; the allowances for doubtful accounts and sales returns; the valuation of goodwill and intangible assets; accounting for business combinations; accounting for stock-based compensation; accounting for long-term facility obligations; the accounting for derivative instruments; accounting for income taxes and related valuation allowances; and loss contingencies. We base our estimates on historical experience, market participant fair value considerations and various other factors that are believed to be reasonable under the circumstances. Actual amounts could differ significantly from these estimates.

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***Basis of Consolidation***

The consolidated financial statements include our accounts and those of our wholly-owned domestic and foreign subsidiaries. Intercompany transactions and balances have been eliminated.

***Reclassification***

We reclassified certain items included within the statements of cash flows for the years ended September 30, 2010 and 2009 to conform with the current year presentation. The reclassifications include combining depreciation and amortization expense and combining the gain on foreign currency forward contracts with other to conform with current year presentation. Such reclassifications have no impact on earnings or cash flows provided by operations.

***Revenue Recognition***

We derive revenue from the following sources: (1) software license agreements, including royalty and other usage-based arrangements, (2) post-contract customer support, (3) fixed and variable fee hosting arrangements and (4) professional services. Our revenue recognition policies for these revenue streams are discussed below.

The sale and/or license of software products and technology is deemed to have occurred when a customer either has taken possession of the related software or technology or has access to take immediate possession of the software or technology. In select situations, we sell or license intellectual property in conjunction with, or in place of, embedding our intellectual property in software. We recognize revenue from the sale or license of software products and licensing of technology when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable and (iv) collectibility is probable. Vendor-specific objective evidence (“VSOE”) of fair value for software and software-related services exists when a company can support what the fair value of its software and/or software-related services is based on evidence of the prices charged when the same elements are sold separately. VSOE of fair value is required, generally, in order to separate the accounting for various elements in a software and related services arrangement. We have established VSOE of fair value for the majority of our post-contract customer support (“PCS”), professional services, and training.

Revenue from royalties on sales of our software products by original equipment manufacturers (“OEMs”), where no services are included, is recognized in the quarter earned so long as we have been notified by the OEM that such royalties are due, and provided that all other revenue recognition criteria are met.

Software arrangements generally include PCS, which includes telephone support and the right to receive unspecified upgrades/enhancements on a when-and-if-available basis, typically for one to five years. Revenue from PCS is generally recognized ratably on a straight-line basis over the term that the maintenance service is provided.

Non-software revenue, such as arrangements containing hosting services where the customer does not take possession of the software at the outset of the arrangement and has no contractual right to do so, is recognized when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the fees are fixed or determinable and (iv) collectibility is reasonably assured.

Effective October 1, 2010, we adopted the provisions in the Financial Accounting Standards Board (“FASB”) Accounting Standards Update (“ASU”) No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements* (“ASU 2009-13”) and ASU 2009-14, *Software (Topic 985): Certain Revenue Arrangements that Include Software Elements* (“ASU 2009-14”). The provisions of ASU 2009-13 apply to arrangements that are outside the scope of software revenue recognition guidance and amend Accounting Standards Codification (“ASC”) Topic 605 to (1) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the consideration allocated; (2) require an entity to allocate revenue in an arrangement using the best estimated selling prices (“BESP”) of deliverables if a vendor does not have vendor-specific objective evidence (“VSOE”) or third-party evidence (“TPE”) of selling price; and (3) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

method. ASU 2009-14 modifies the scope of ASC Topic 985 to remove industry specific revenue accounting guidance for software and software related transactions, tangible products containing software components and non-software components that function together to deliver the product's essential functionality. The adoption of these provisions did not have a material impact on our consolidated financial statements.

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

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

Revenue from products offered on a subscription and/or hosted, on-demand basis is recognized in the period the services are provided, based on a fixed minimum fee and/or variable fees based on the volume of activity. Variable subscription and hosting revenue is recognized as we are notified by the customer or through management reports that such revenue is due, provided that all other revenue recognition criteria are met.

Set-up fees from arrangements containing hosting services, as well as the associated direct and incremental costs, are deferred and recognized ratably over the longer of the contract lives, or the expected lives of the customer relationships.

When we provide professional services considered essential to the functionality of the software, we recognize revenue from the professional services as well as any related software licenses on a percentage-of-completion basis whereby the arrangement consideration is recognized as the services are performed, as measured by an observable input. In these circumstances, we separate license revenue from professional service revenue for income statement presentation by allocating VSOE of fair value of the professional services as professional service revenue and the residual portion as license revenue. We generally determine the percentage-of-completion by comparing the labor hours incurred to-date to the estimated total labor hours required to complete the project. We consider labor hours to be the most reliable, available measure of progress on these projects. Adjustments to estimates to complete are made in the periods in which facts resulting in a change become known. When the estimate indicates that a loss will be incurred, such loss is recorded in the period identified. Significant judgments and estimates are involved in determining the percent complete of each contract. Different assumptions could yield materially different results.

When products are sold through distributors or resellers, title and risk of loss generally passes upon shipment, at which time the transaction is invoiced and payment is due. Shipments to distributors and resellers without right of return are recognized as revenue upon shipment, provided all other revenue recognition criteria are met. Certain distributors and value-added resellers have been granted rights of return for as long as the distributors or resellers hold the inventory. We cannot use historical returns from these distributors and resellers as a basis upon which to estimate future sales returns. As a result, we recognize revenue from sales to these distributors and resellers when the products are sold through to retailers and end-users.

When products are sold directly to retailers or end-users, we make an estimate of sales returns based on historical experience. The provision for these estimated returns is recorded as a reduction of revenue and accounts receivable at the time that the related revenue is recorded. If actual returns differ significantly from our estimates,

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

such differences could have a material impact on our results of operations for the period in which the actual returns become known.

When maintenance and support contracts renew automatically, we provide a reserve based on historical experience for contracts expected to be cancelled for non-payment. All known and estimated cancellations are recorded as a reduction to revenue and accounts receivable.

We record consideration given to a reseller as a reduction of revenue to the extent we have recorded cumulative revenue from the customer or reseller. However, when we receive an identifiable benefit in exchange for the consideration, and can reasonably estimate the fair value of the benefit received, the consideration is recorded as an operating expense.

We record reimbursements received for out-of-pocket expenses as revenue, with offsetting costs recorded as cost of revenue. Out-of-pocket expenses generally include, but are not limited to, expenses related to transportation, lodging and meals.

We record shipping and handling costs billed to customers as revenue with offsetting costs recorded as cost of revenue.

Deferred revenue at September 30, 2011 and 2010 were as follows (dollars in thousands):

|                                  | <u>September 30,</u><br><u>2011</u> | <u>September 30,</u><br><u>2010</u> |
|----------------------------------|-------------------------------------|-------------------------------------|
| <b>Current Liabilities:</b>      |                                     |                                     |
| Deferred maintenance revenue     | \$ 101,480                          | \$ 90,969                           |
| Unearned revenue                 | <u>84,125</u>                       | <u>51,371</u>                       |
| Total current deferred revenue   | <u>\$ 185,605</u>                   | <u>\$ 142,340</u>                   |
| <b>Long-term Liabilities:</b>    |                                     |                                     |
| Deferred maintenance revenue     | \$ 22,712                           | \$ 12,902                           |
| Unearned revenue                 | <u>67,670</u>                       | <u>63,696</u>                       |
| Total long-term deferred revenue | <u>\$ 90,382</u>                    | <u>\$ 76,598</u>                    |

The increase in the deferred maintenance revenue is primarily related to an increase in Imaging maintenance and support as well as an increase in Enterprise application maintenance. Unearned revenue increased as a result of set-up fees on new hosting arrangements as well as billings in excess of revenues earned on several large professional service implementation projects.

***Business Combinations***

We determine and allocate the purchase price of an acquired company to the tangible and intangible assets acquired and liabilities assumed as of the business combination date. Results of operations and cash flows of acquired companies are included in our operating results from the date of acquisition. The purchase price allocation process requires us to use significant estimates and assumptions, including fair value estimates, as of the business combination date including:

- estimated fair values of intangible assets;
- estimated fair market values of legal performance commitments to customers, assumed from the acquiree under existing contractual obligations (classified as deferred revenue) at the date of acquisition;
- estimated fair market values of stock awards assumed from the acquiree that are included in the purchase price;



**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

- estimated fair market value of required payments under contingent consideration provisions;
- estimated income tax assets and liabilities assumed from the acquiree; and
- estimated fair value of pre-acquisition contingencies assumed from the acquiree.

While we use our best estimates and assumptions as a part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the business combination date, our estimates and assumptions are inherently uncertain and subject to refinement. As a result, during the purchase price allocation period, which is generally one year from the business combination date, we record adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill. Subsequent to the purchase price allocation period any adjustment to assets acquired or liabilities assumed is included in operating results in the period in which the adjustment is determined.

***Goodwill and Indefinite-Lived Intangible Assets***

Goodwill represents the excess of the purchase price in a business combination over the fair value of net tangible and intangible assets acquired. Goodwill and intangible assets with indefinite lives are not amortized, but rather the carrying amounts of these assets are reviewed for impairment at least annually or whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. Our annual impairment assessment date is July 1 of each fiscal year. Goodwill is evaluated for impairment based on a comparison of the fair value of our reporting units to their recorded carrying values. In fiscal 2011, we changed our reportable segments, and as a result the underlying reporting units changed as well. We now have seven reporting units based on the level of information provided to, and review thereof, by our segment management. Goodwill was reallocated to the new reporting units based on the relative fair values of the reporting units at the date we implemented the change.

We determine fair values for each of the reporting units using an income approach. When available and appropriate, we also use a comparative market approach to derive the fair values. For purposes of the income approach, fair value is determined based on the present value of estimated future cash flows, discounted at an appropriate risk adjusted rate. We use our internal forecasts to estimate future cash flows and include an estimate of long-term future growth rates based on our most recent views of the long-term outlook for each business. Actual results may differ from those assumed in our forecasts. We derive our discount rates using a capital asset pricing model and analyzing published rates for industries relevant to our reporting units to estimate the cost of equity financing. We use discount rates that are commensurate with the risks and uncertainty inherent in the respective businesses and in our internally developed forecasts. Discount rates used in our reporting unit valuations ranged from 13% to 23%. For purposes of the market approach, we use a valuation technique in which values are derived based on market prices of comparable publically traded companies. We also use a market based valuation technique in which values are determined based on relevant observable information generated by market transactions involving comparable businesses. We assess each valuation methodology based upon the relevance and availability of the data at the time we perform the valuation and weight the methodologies appropriately. The carrying values of the reporting units were determined based on an allocation of our assets and liabilities through specific allocation of certain assets and liabilities to the reporting units and an apportionment method based on relative size of the reporting units' revenues and operating expenses compared to the Company as a whole. Certain corporate assets that are not instrumental to the reporting units' operations and would not be transferred to hypothetical purchasers of the reporting units were excluded from the reporting units' carrying values. Indefinite-lived intangibles are evaluated for impairment through comparison of the fair value of the assets to their net book value.

***Long-Lived Assets***

Our long-lived assets consist principally of acquired intangible assets and land, building and equipment. Land, building and equipment are stated at cost. Building and equipment are depreciated over their estimated useful lives.

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Leasehold improvements are depreciated over the shorter of the related lease term or the estimated useful life. Costs of significant improvements on existing software for internal use are capitalized and depreciated over the estimated useful life. Depreciation is computed using the straight-line method. Repair and maintenance costs are expensed as incurred. The cost and related accumulated depreciation of sold or retired assets are removed from the accounts and any gain or loss is included in operations.

We include in our amortizable intangible assets those intangible assets acquired in our business and asset acquisitions, including certain technology that is licensed from third parties. We amortize acquired intangible assets with finite lives over the estimated economic lives of the assets, generally using the straight-line method except where the pattern of the expected economic benefit is readily identifiable, primarily customer relationship intangibles, whereby amortization follows that pattern. Each period, we evaluate the estimated remaining useful life of acquired and licensed intangible assets, as well as land, buildings and equipment, to determine whether events or changes in circumstances warrant a revision to the remaining period of depreciation or amortization.

We evaluate long-lived assets for impairment whenever events or changes in circumstances indicate the carrying value of an asset or asset group may not be recoverable. We assess the recoverability of the assets based on the undiscounted future cash flows the assets are expected to generate and recognize an impairment loss when estimated undiscounted future cash flows expected to result from the use of the assets plus net proceeds expected from disposition of the assets, if any, are less than the carrying value of the assets. If an asset or asset group is deemed to be impaired, the amount of the impairment loss, if any, represents the excess of the asset or asset group's carrying value compared to its estimated fair value.

***Cash and Cash Equivalents***

Cash and cash equivalents consists of cash on hand, including money market funds and time deposits with original maturities of 90 days or less.

***Marketable Securities and Minority Investments***

*Marketable Securities:* Investments are classified as available-for-sale and are recorded on the balance sheet at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income, net of tax. Marketable securities consist primarily of high-quality corporate debt instruments and have maturity dates ranging from February 2012 through June 2012. As of September 30, 2011, the total cost basis was \$31.3 million.

*Minority Investment:* We record investments in other companies where we do not have a controlling interest or significant influence in the equity investment at cost within other assets in our consolidated balance sheet. We review our investments for impairment whenever declines in estimated fair value are deemed to be other-than-temporary.

***Accounts Receivable Allowances***

*Allowances for Doubtful Accounts:* We maintain an allowance for doubtful accounts for the estimated probable losses on uncollectible accounts receivable. The allowance is based upon the credit worthiness of our customers, our historical experience, the age of the receivable and current market and economic conditions. Receivables are written off against these allowances in the period they are determined to be uncollectible.

*Allowances for Sales Returns:* We maintain an allowance for sales returns from customers for which we have the ability to estimate returns based on historical experience. The returns allowance is recorded as a reduction in revenue and accounts receivable at the time the related revenue is recorded. Receivables are written off against the allowance in the period the return is received.

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

For the years ended September 30, 2011, 2010 and 2009, the activity related to accounts receivable allowances was as follows (in thousands):

|                               | <u>Allowance for<br/>Doubtful Accounts</u> | <u>Allowance for<br/>Sales Returns</u> |
|-------------------------------|--|--|
| Balance at October 1, 2008    | 6,925                                      | 6,363                                  |
| Bad debt provision            | 1,823                                      | —                                      |
| Write-offs, net of recoveries | (1,915)                                    | —                                      |
| Revenue adjustments, net      | —  | (257)                                  |
| Balance at September 30, 2009 | 6,833                                      | 6,106                                  |
| Bad debt provisions           | 873  | —                                      |
| Write-offs, net of recoveries | (1,405)                                    | —                                      |
| Revenue adjustments, net      | —  | 723                                    |
| Balance at September 30, 2010 | 6,301                                      | 6,829                                  |
| Bad debt provisions           | 1,332                                      | —                                      |
| Write-offs, net of recoveries | (1,926)                                    | —                                      |
| Revenue adjustments, net      | —  | (596)                                  |
| Balance at September 30, 2011 | <u>\$ 5,707</u>                            | <u>\$ 6,233</u>                        |

***Inventories***

Inventories are stated at the lower of cost, computed using the first-in, first-out method, or market value and are included in other current assets. We regularly review inventory quantities on hand and record a provision for excess and/or obsolete inventory primarily based on future purchase commitments with our suppliers, and the estimated utility of our inventory as well as other factors including technological changes and new product development.

Inventories, net of allowances, consisted of the following (dollars in thousands):

|                        | <u>September 30,<br/>2011</u> | <u>September 30,<br/>2010</u> |
|------------------------|-------------------------------|-------------------------------|
| Components and parts   | \$ 6,279                      | \$ 5,357                      |
| Inventory at customers | 275                           | 936                           |
| Finished products      | 4,797                         | 2,308                         |
|                        | <u>\$ 11,351</u>              | <u>\$ 8,601</u>               |

Inventory at customers reflects equipment related to in-process installations of solutions with customers. These contracts have not been recorded as revenue as of the balance sheet date, and therefore the related equipment is recorded in inventory until installation is complete.

***Research and Development Costs***

Internal costs relating to research and development incurred for new software products and enhancements to existing products are expensed as incurred.

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***Accounting for Collaboration Agreements***

*Healthcare Collaboration Agreement*

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

As of the execution of the above arrangement, we have other arrangements where we have sold and will continue to sell our products and services to this party. As a result, under the guidance of ASC 605, *Revenue Recognition*, we are required to reduce the revenue recognized by the amount we pay to this customer, up to our historical revenue recorded from them. We have therefore reduced reported revenue by \$10.0 million for the fiscal year ended September 30, 2011.

The above development arrangement will be accounted for in accordance with ASC 730, *Research and Development*. Accordingly, any buy-out obligation will be recorded as a liability and any reimbursement of the research and development costs in excess of the buy-out obligation will be recorded as an offset to research and development costs. Royalties paid to this party upon commercialization of any products from these development efforts will be recorded as a reduction to revenue in accordance with ASC 605. For fiscal year ended September 30, 2011, \$5.9 million of expense reimbursement has been recorded as a reduction in research and development expense.

*Intellectual Property Collaboration Agreements*

In order to gain access to a third party's extensive speech recognition technology, natural language and semantic process technology, in fiscal 2010 and 2011 we entered into three intellectual property collaboration agreements with terms up to six years. Generally, the agreements call for annual payments in cash or shares of our common stock, at our election. Payments are estimated to be \$23.4 million, \$23.4 million and \$5 million in each of the next three years. Depending on the agreement, some or all intellectual property derived from these collaborations will be jointly owned by the two parties. For the majority of the developed intellectual property, we will have sole rights to commercialize such intellectual property for periods ranging between two to six years, depending on the agreement. The following is a summary of the payments made during fiscal 2010 and 2011 under these three agreements (dollars in thousands):

| <u>Payment Date</u> | <u>Number of<br/>Shares Issued</u> | <u>Total Value<br/>of Shares</u> |
|---------------------|------------------------------------|----------------------------------|
| October 14, 2009    | 1,047,120                          | \$ 16,000                        |
| March 31, 2010      | 145,897                            | \$ 2,400                         |
| June 24, 2010       | 152,440                            | \$ 2,500                         |
| September 28, 2010  | 1,178,732                          | \$ 18,400                        |
| April 1, 2011       | 127,878                            | \$ 2,500                         |
| June 25, 2011       | 123,275                            | \$ 2,500                         |
| August 18, 2011     | 1,023,360                          | \$ 18,400                        |

The payments are recorded as a prepaid asset when made, and will be expensed ratably over the contractual period. For the years ended September 30, 2011 and 2010, we have recognized \$19.8 million and \$16.7 million as

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

research and development expense, respectively, related to these agreements in our consolidated statements of operations.

***Software Development Costs***

Software development costs related to software that is or will be sold or licensed externally to third-parties, or for which a substantive plan exists to sell or license such software in the future, incurred subsequent to the establishment of technological feasibility, but prior to the general release of the product, are capitalized and amortized to cost of revenue over the estimated useful life of the related products. We have determined that technological feasibility is reached shortly before the general release of our software products. Costs incurred after technological feasibility is established have not been material, and accordingly, we have expensed the internal costs relating to research and development when incurred.

***Capitalized Patent Defense Costs***

We monitor the anticipated outcome of legal actions, and if we determine that the success of the defense of a patent is probable, and so long as we believe that the future economic benefit of the patent will be increased, we capitalize external legal costs incurred in the defense of these patents, up to the level of the expected increased future economic benefit. If changes in the anticipated outcome occur, we write-off any capitalized costs in the period the change is determined. Upon successful defense of the patent, the amounts previously capitalized are amortized over the remaining life of the patent. During fiscal 2010, we expensed \$6.8 million of deferred costs included in restructuring and other charges, net as a result of unsuccessful litigation. As of September 30, 2011 and 2010, there are no capitalized patent defenses costs.

***Acquisition-Related Costs, net***

During the first quarter of fiscal 2010, we adopted the guidance in ASC 805, *Business Combinations*. ASC 805 supersedes the previous accounting guidance related to business combinations, including the measurement of acquirer shares issued in consideration for a business combination, the recognition of and subsequent accounting for contingent consideration, the recognition of acquired in-process research and development, the accounting for acquisition-related restructurings, the treatment of acquisition-related transaction costs and the recognition of changes in the acquirer's income tax valuation allowance. The guidance is applied prospectively from the date of acquisition with a minor exception related to income tax contingencies from companies acquired prior to the adoption date. As a result of our adoption of the new guidance, we expensed \$2.2 million in acquisition-related transaction costs which were capitalized as of September 30, 2009. These costs were recorded as expense within the "acquisition-related costs, net" line in the consolidated statement of operations.

Acquisition-related costs include those costs related to business and other acquisitions, including potential acquisitions. These costs consist of transition and integration costs, including retention payments, transitional employee costs and earn-out payments treated as compensation expense, as well as the costs of integration-related services provided by third-parties; professional service fees, including direct third-party costs of the transaction and post-acquisition legal and other professional service fees associated with disputes and regulatory matters related to acquired entities; and adjustments to acquisition-related items that are required to be marked to fair value each reporting period, such as contingent consideration, and other items related to acquisitions for which the measurement period has ended. Previous to our adoption of ASC 805, direct transaction costs were included as a part of the consideration transferred and capitalized as goodwill. In addition, there were no items under the legacy business combination accounting guidance that were required to be re-measured to fair value on a recurring basis.

NUANCE COMMUNICATIONS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

|                                  | <u>2011</u>     | <u>2010</u>      | <u>2009</u>     |
|----------------------------------|-----------------|------------------|-----------------|
| Transition and integration costs | \$ 3,361        | \$ 13,562        | \$ 4,698        |
| Professional service fees        | 18,030          | 17,156           | 15,048          |
| Acquisition-related adjustments  | 475             | (107)            | (4,043)         |
| Total                            | <u>\$21,866</u> | <u>\$ 30,611</u> | <u>\$15,703</u> |

#### *Advertising Costs*

Advertising costs are expensed as incurred and are classified as sales and marketing expenses. Cooperative advertising programs reimburse customers for marketing activities for certain of our products, subject to defined criteria. Cooperative advertising obligations are accrued and the costs expensed at the same time the related revenue is recognized. Cooperative advertising expenses are recorded as expense to the extent that an advertising benefit separate from the revenue transaction can be identified and the cash paid does not exceed the fair value of that advertising benefit received. Any excess of cash paid over the fair value of the advertising benefit received is recorded as a reduction in revenue. We incurred advertising costs of \$30.6 million, \$21.1 million and \$15.8 million for fiscal 2011, 2010 and 2009, respectively.

#### *Convertible Debt*

We separately account for the liability (debt) and equity (conversion option) components of our convertible debt instruments that require or permit settlement in cash upon conversion in a manner that reflects our nonconvertible debt borrowing rate at the time of issuance. The equity components of our convertible debt instruments are recorded to stockholders' equity with an offsetting debt discount. The debt discount created is amortized to interest expense in our consolidated statement of operations using the effective interest method over the expected term of the convertible debt.

#### *Income Taxes*

Deferred tax assets and liabilities are determined based on differences between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. We do not provide for U.S. income taxes on the undistributed earnings of our foreign subsidiaries, which we consider to be indefinitely reinvested outside of the U.S.

We make judgments regarding the realizability of our deferred tax assets. The balance sheet carrying value of our net deferred tax assets is based on whether we believe that it is more likely than not that we will generate sufficient future taxable income to realize these deferred tax assets after consideration of all available evidence. We regularly review our deferred tax assets for recoverability considering historical profitability, projected future taxable income, and the expected timing of the reversals of existing temporary differences and tax planning strategies.

Valuation allowances have been established for U.S. and certain foreign deferred tax assets, which we believe do not meet the "more likely than not" criteria for recognition. If we are subsequently able to utilize all or a portion of the deferred tax assets for which a valuation allowance has been established, then we may be required to recognize these deferred tax assets through the reduction of the valuation allowance which could result in a material benefit to our results of operations in the period in which the benefit is determined. This benefit will exclude the recognition of the portion of the valuation allowance which relates to net deferred tax assets created as a result of stock-based compensation or other equity transactions where prevailing guidance requires the change in valuation allowance to be traced forward through stockholders' equity and recorded as additional paid-in-capital.

We establish reserves for tax uncertainties that reflect the use of the comprehensive model for the recognition and measurement of uncertain tax positions. Under the comprehensive model, when the minimum threshold for

## NUANCE COMMUNICATIONS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

recognition is not met, no tax benefit can be recorded. When the minimum threshold for recognition is met, a tax position is recorded as the largest amount that is more than fifty percent likely of being realized upon ultimate settlement.

***Comprehensive Income (Loss)***

Total comprehensive income (loss), net of taxes, was approximately \$32.1 million, \$(18.2) million and \$(24.6) million for fiscal 2011, 2010 and 2009, respectively. For the purposes of comprehensive income (loss) disclosures, we do not record tax provisions or benefits for the net changes in the foreign currency translation adjustment, as we intend to reinvest undistributed earnings in our foreign subsidiaries permanently.

The components of accumulated other comprehensive income, reflected in the Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss), consisted of the following (dollars in thousands):

|  | <u>2011</u>     | <u>2010</u>     | <u>2009</u>     |
|--|-----------------|-----------------|-----------------|
| Foreign currency translation adjustment                      | \$ 4,320        | \$ 13,067       | \$ 15,874       |
| Unrealized gains (losses) on marketable securities           | (12)            | 30              | —               |
| Net unrealized gains (losses) on cash flow hedge derivatives | 20              | 230             | (3,982)         |
| Net unrealized losses on post-retirement benefits            | (1,926)         | (4,822)         | (4,325)         |
| Total  | <u>\$ 2,402</u> | <u>\$ 8,505</u> | <u>\$ 7,567</u> |

***Concentration of Risk***

Financial instruments that potentially subject us to significant concentrations of credit risk principally consist of cash, cash equivalents, and trade accounts receivable. We place our cash and cash equivalents with financial institutions with high credit ratings. As part of our cash and investment management processes, we perform periodic evaluations of the credit standing of the financial institutions with whom we maintain deposits, and have not recorded any credit losses to-date. For trade accounts receivable, we perform ongoing credit evaluations of our customers' financial condition and limit the amount of credit extended when deemed appropriate. At September 30, 2011 and 2010, no customer accounted for greater than 10% of our net accounts receivable balance. No customer accounted for more than 10% of our revenue for fiscal 2011, 2010 or 2009.

***Fair Value of Financial Instruments***

Financial instruments including cash equivalents, marketable securities, accounts receivable, accounts payable, and derivative instruments, are carried in the financial statements at amounts that approximate their fair value based on the short maturities of those instruments. Refer to Note 10 for discussion of the fair value of our long-term debt.

***Foreign Currency Translation***

We have significant foreign operations and transact business in various foreign currencies. In general, the functional currency of a foreign operation is the local country's currency. Non-functional currency monetary balances are re-measured into the functional currency of the subsidiary with any related gain or loss recorded in other income (expense), net, in the accompanying consolidated statements of operations. Assets and liabilities of operations outside the United States, for which the functional currency is the local currency, are translated into United States dollars using period-end exchange rates. Revenue and expenses are translated at the average exchange rates in effect during each fiscal month during the year. The effects of foreign currency translation adjustments are included as a component of accumulated other comprehensive income in the accompanying consolidated balance sheets. Foreign currency transaction gains (losses) included in net income (loss) for fiscal 2011, 2010, and 2009 were \$(1.1) million, \$3.5 million, and \$7.0 million, respectively.

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***Financial Instruments and Hedging Activities***

We utilize derivative instruments to hedge specific financial risks such as interest rate and foreign exchange risk. We do not engage in speculative hedging activity. In order for us to account for a derivative instrument as a hedge, specific criteria must be met, including: (i) ensuring at the inception of the hedge that formal documentation exists for both the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge and (ii) at the inception of the hedge and on an ongoing basis, the hedging relationship is expected to be highly effective in achieving offsetting changes in fair value attributed to the hedged risk during the period that the hedge is designated. Further, an assessment of effectiveness is required whenever financial statements or earnings are reported. Absent meeting these criteria, changes in fair value are recognized in other income (expense), net, in the consolidated statements of operations. Once the underlying forecasted transaction is realized, the gain or loss from the derivative designated as a hedge of the transaction is reclassified from accumulated other comprehensive income (loss) to the statement of operations, in the appropriate revenue or expense caption. Any ineffective portion of the derivatives designated as cash flow hedges is recognized in current earnings.

***Accounting for Stock-Based Compensation***

We account for stock-based compensation to employees and directors, including grants of employee stock options, purchases under employee stock purchase plans, awards in the form of restricted shares ("Restricted Stock") and awards in the form of units of stock purchase rights ("Restricted Units") through recognition of the fair value of the stock-based compensation as a charge against earnings. We recognize stock-based compensation expense over the requisite service period, net of estimated forfeitures. We will recognize a benefit from stock-based compensation in equity using the with-and-without approach for the utilization of tax attributes. The Restricted Stock and Restricted Units are collectively referred to as "Restricted Awards."

***Net Income (Loss) Per Share***

We compute net income (loss) per share in accordance with the two-class method. Under the two-class method, basic net income per share is computed by dividing the net income available to common stockholders by the weighted-average number of common shares outstanding during the period. Net losses are not allocated to preferred stockholders. We have determined that our outstanding Series B convertible preferred stock represents a participating security and as such the preferred shares are excluded from basic earnings per share.

Diluted net income per share is computed using the more dilutive of (a) the two-class method, or (b) the if-converted method. We allocate net income first to preferred stockholders based on dividend rights and then to common and preferred stockholders based on ownership interests. The weighted-average number of common shares outstanding gives effect to all potentially dilutive common equivalent shares, including outstanding stock options and restricted stock, shares held in escrow, contingently issuable shares under earn-out agreements once earned, warrants, and potential issuance of stock upon conversion of our 2.75% Convertible Debentures. The convertible debentures are considered Instrument C securities due to the fact that only the excess of the conversion value on the date of conversion can be paid in our common shares; the principal portion of the conversion must be paid in cash. Therefore, only the shares of common stock potentially issuable with respect to the excess of the conversion value over its principal amount, if any, is considered as dilutive potential common shares for purposes of calculating diluted net income per share. The conversion value for the convertible debentures was less than the principal amount for each of the years in the three year period ended September 30, 2011 and no shares were assumed to be issued for purposes of computing the diluted net income (loss) per share.



**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The following table sets forth the computation for basic and diluted net income (loss) per share for the years ended September 30, 2011, 2010 and 2009 (dollars in thousands, except per share amounts):

|  | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|--|-------------|-------------|-------------|
| <b>Numerator:</b>  |             |             |             |
| <b>Basic</b>   |             |             |             |
| Net income (loss)  | \$ 38,238   | \$(19,099)  | \$ (19,387) |
| Allocation of undistributed earnings to preferred stockholders | (445)       | —           | —           |
| Net income (loss) available to common stockholders — basic     | \$ 37,793   | \$(19,099)  | \$ (19,387) |
| <b>Diluted</b>   |             |             |             |
| Net income (loss) available to common stockholders — diluted   | \$ 38,238   | \$(19,099)  | \$ (19,387) |
| <b>Denominator:</b>  |             |             |             |
| <b>Basic</b>   |             |             |             |
| Weighted average common shares outstanding                     | 302,277     | 287,412     | 253,644     |
| <b>Diluted</b>   |             |             |             |
| Weighted average common shares outstanding — basic             | 302,277     | 287,412     | 253,644     |
| Weighted average effect of dilutive common equivalent shares:  |             |             |             |
| Assumed conversion of Series B Preferred Stock                 | 3,562       | —           | —           |
| Employee stock compensation plans                              | 8,457       | —           | —           |
| Warrants   | 1,499       | —           | —           |
| Other contingently issuable shares                             | 165         | —           | —           |
| Weighted average common shares outstanding — diluted           | 315,960     | 287,412     | 253,644     |
| <b>Net income (loss) per share:</b>                            |             |             |             |
| Basic  | \$ 0.13     | \$ (0.07)   | \$ (0.08)   |
| Diluted  | \$ 0.12     | \$ (0.07)   | \$ (0.08)   |

Common equivalent shares are excluded from the computation of diluted net income (loss) per share if their effect is anti-dilutive. Potentially dilutive common equivalent shares aggregating to 3.2 million shares, 20.7 million shares and 31.6 million shares for the years ended September 30, 2011, 2010 and 2009, respectively, have been excluded from the computation of diluted net income (loss) per share because their inclusion would be anti-dilutive.

***Recently Issued Accounting Standards***

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

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards*, to provide consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements, particularly for level 3 fair value measurements (as defined in Note 12). ASU 2011-04 is effective for periods beginning after December 15, 2011. We are currently evaluating the impact on our fair value measures.

In December 2010, the FASB issued ASU No. 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations*, to provide guidelines for how pro forma disclosures are calculated. In addition, ASU 2010-29 expands the disclosure requirements and requires a description of the nature and amount of any material, nonrecurring pro forma adjustments directly attributable to a business combination and is effective for fiscal years beginning after December 15, 2010. ASU 2010-29 impacts disclosure only and therefore, did not, and is not expected to, have a material impact on our financial statements.

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

In January 2010, the FASB issued Accounting Standards Update No. 2010-06, *Improving Disclosures about Fair Value Measurements (Topic 820) — Fair Value Measurements and Disclosures* (“ASU 2010-06”), which requires additional disclosures about the different classes of assets and liabilities measured at fair value, the valuation techniques and inputs used, the activity in Level 3 fair value measurements, and transfers between Levels 1, 2 and 3. Levels 1, 2 and 3 of fair value measurements are defined in Note 12. ASU 2010-06 was effective for us for the interim reporting period beginning January 1, 2010, except for the provisions related to activity in Level 3 fair value measurements. Those provisions are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. ASU 2010-06 impacts disclosure only and therefore, did not, and is not expected to, have a material impact on our financial statements.

### 3. Business Acquisitions

#### 2011 Acquisitions

##### *Fiscal 2011 Acquisitions*

On June 15, 2011, we acquired all of the outstanding capital stock of Equitrac, a leading provider of print management solutions, to expand the offerings of our Imaging segment, for cash consideration of approximately \$162.0 million. The acquisition was a stock purchase and the goodwill resulting from this acquisition is not expected to be deductible for tax purposes. The results of operations of Equitrac have been included in our results of operations from June 15, 2011.

On June 16, 2011, we acquired all of the outstanding capital stock of SVOX, a Swiss based seller of speech recognition, dialog, and text-to-speech software products for the automotive, mobile and consumer electronics industries in our Mobile and Consumer segment. Total purchase consideration was €87.0 million which consists of cash consideration of €57.0 million (\$80.9 million based on the exchange rate as of the date of acquisition) and a deferred acquisition payment of €30.0 million (\$43.0 million based on the exchange rate as of the date of acquisition). The deferred acquisition payment is payable in cash or shares of our common stock, at our option; €8.3 million of the deferred acquisition payment is due on June 16, 2012 and the remaining €21.7 million is due on December 31, 2012. The acquisition was a stock purchase and the goodwill resulting from this acquisition is not

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

expected to be deductible for tax purposes. The results of operations of SVOX have been included in our results of operations from June 16, 2011.

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

|   | <u>Equitrac</u>   | <u>SVOX</u>       |
|---|-------------------|-------------------|
| Total purchase consideration:             |                   |                   |
| Cash                                      | \$ 161,950        | \$ 80,919         |
| Deferred acquisition payment              | —                 | 42,990            |
| Total purchase consideration              | <u>\$ 161,950</u> | <u>\$ 123,909</u> |
| Allocation of the purchase consideration: |                   |                   |
| Cash                                      | \$ 115            | \$ —              |
| Accounts receivable(a)                    | 10,724            | 3,506             |
| Inventory                                 | 2,462             | —                 |
| Goodwill                                  | 87,439            | 88,459            |
| Identifiable intangible assets(b)         | 91,900            | 42,165            |
| Other assets                              | 10,883            | 2,728             |
| Total assets acquired                     | 203,523           | 136,858           |
| Current liabilities                       | (3,262)           | (9,664)           |
| Deferred tax liability                    | (38,311)          | (3,285)           |
| Total liabilities assumed                 | <u>(41,573)</u>   | <u>(12,949)</u>   |
| Net assets acquired                       | <u>\$ 161,950</u> | <u>\$ 123,909</u> |

- (a) Accounts receivable have been recorded at their estimated fair values, which consists of the gross accounts receivable assumed of \$15.2 million, reduced by a fair value reserve of \$1.0 million representing the portion of contractually owed accounts receivable which we do not expect to be collected.
- (b) The following are the identifiable intangible assets acquired and their respective weighted average useful lives, as determined based on preliminary valuations (dollars in thousands):

|                               | <u>Equitrac</u> |  | <u>SVOX</u>     |  |
|-------------------------------|-----------------|--|-----------------|--|
|                               | <u>Amount</u>   | <u>Weighted<br/>Average<br/>Life (Years)</u> | <u>Amount</u>   | <u>Weighted<br/>Average<br/>Life (Years)</u> |
| Customer relationships        | \$55,800        | 15.0   | \$35,612        | 13.4   |
| Core and completed technology | 22,000          | 7.0  | 6,268           | 5.0  |
| Trade name                    | 14,100          | 10.0   | 285             | 3.0  |
| Total                         | <u>\$91,900</u> |  | <u>\$42,165</u> |  |

***Other Fiscal 2011 Acquisitions***

During fiscal 2011, we acquired three additional businesses, primarily to expand our product offerings and enhance our technology base. The results of operations of these acquisitions have been included in our consolidated results from their respective acquisition dates. The total consideration for these acquisitions was \$157.3 million, paid in cash. In allocating the total purchase consideration for these acquisitions based on estimated fair values, we preliminarily recorded \$96.2 million of goodwill and \$57.8 million of identifiable intangible assets. The allocations

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

of the purchase consideration are based upon preliminary valuations and our estimates and assumptions are subject to change. Intangible assets acquired included primarily customer relationships and core and completed technology with weighted average useful lives of 12.4 years. The acquisitions were stock acquisitions and the goodwill resulting from these transactions is not expected to be deductible for tax purposes.

**2010 Acquisitions**

***Acquisition of SpinVox***

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

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

|   |                   |
|---|-------------------|
| Total purchase consideration:             |                   |
| Cash                                      | \$ 67,500         |
| Common Stock(a)                           | 36,352            |
| Total purchase consideration              | <u>\$ 103,852</u> |
| Allocation of the purchase consideration: |                   |
| Cash                                      | \$ 4,061          |
| Accounts receivable(b)                    | 12,419            |
| Other assets                              | 5,861             |
| Property and equipment                    | 1,585             |
| Identifiable intangible assets            | 32,400            |
| Goodwill                                  | <u>109,726</u>    |
| Total assets acquired                     | 166,052           |
| Current liabilities(c)                    | (61,148)          |
| Deferred revenue                          | <u>(1,052)</u>    |
| Total liabilities assumed                 | <u>(62,200)</u>   |
| Net assets acquired                       | <u>\$ 103,852</u> |

- (a) Approximately 2.3 million shares of our common stock, valued at \$15.81 per share based on the closing price of our common stock on the acquisition date, were issued at closing.
- (b) Accounts receivable have been recorded at their estimated fair value, which consists of the gross accounts receivable assumed of \$15.3 million, reduced by a fair value reserve of \$2.9 million representing the portion of contractually owed accounts receivable which we do not expect to be collected.
- (c) Current liabilities include a commitment of EUR 25.0 million (\$36.0 million based on the December 31, 2009 exchange rate) fixed obligation, payable in cash.

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

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

|                               | <u>Amount</u>    | <u>Weighted<br/>Average<br/>Life</u><br>(In years) |
|-------------------------------|------------------|--|
| Customer relationships        | \$ 23,400        | 12.0   |
| Core and completed technology | 8,400            | 4.7  |
| Non-compete agreements        | 600              | 2.0  |
| Total                         | <u>\$ 32,400</u> |  |

***Other Fiscal 2010 Acquisitions***

During fiscal 2010, we acquired an additional seven businesses primarily to expand our product offerings and enhance our technology base. The results of operations of these companies have been included in our consolidated results from their respective acquisition dates. The total consideration for these acquisitions was \$86.3 million, including the issuance of 1.2 million shares of our common stock valued at \$21.8 million. In allocating the total purchase consideration for these acquisitions based on estimated fair values, we recorded \$43.6 million of goodwill and \$34.5 million of identifiable intangible assets. Intangible assets acquired included primarily core and completed technology and customer relationships with weighted average useful lives of 6.5 years. The acquisitions were primarily stock acquisitions and the goodwill resulting from these acquisitions is not expected to be deductible for tax purposes.

**2009 Acquisitions**

***Acquisition of SNAPin***

On October 1, 2008, we acquired all of the outstanding capital stock of SNAPin, a developer of self-service software for mobile devices, to expand our Enterprise offerings. The goodwill resulting from this transaction is not expected to be deductible for tax purposes.

In connection with our acquisition of SNAPin, we agreed to make a contingent earn-out payment of up to \$45.0 million to be paid, if at all, based on the business achieving certain performance targets that are measurable from the acquisition date to December 31, 2009. In April 2010, a final earn out amount of \$21.2 million was agreed upon; we issued 593,676 shares of our common stock, valued at \$10.2 million, as our first payment under the earn-out agreement. The remaining balance was paid in cash in October 2011 and is included in short-term liabilities as of September 30, 2011.

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

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

|  |                   |
|--|-------------------|
| Total purchase consideration:                    |                   |
| Common stock(a)                                  | \$ 166,253        |
| Stock options and restricted stock units assumed | 11,523            |
| Contingent earn-out consideration                | 21,200            |
| Transaction costs                                | 2,825             |
| Total purchase consideration                     | <u>\$ 201,801</u> |
| Allocation of the purchase consideration:        |                   |
| Current assets                                   | \$ 6,084          |
| Other assets                                     | 2,972             |
| Deferred tax asset(b)                            | 2,327             |
| Identifiable intangible assets                   | 60,900            |
| Goodwill   | 161,558           |
| Total assets acquired                            | 233,841           |
| Current liabilities                              | (2,191)           |
| Deferred tax liability(b)                        | (2,327)           |
| Deferred revenue(c)                              | (27,522)          |
| Total liabilities assumed                        | (32,040)          |
| Net assets acquired                              | <u>\$ 201,801</u> |

- (a) Approximately 9.5 million shares of our common stock valued at \$15.81 per share were issued at closing and 1.1 million shares valued at \$14.11 per share were issued upon release of shares held in escrow.
- (b) We recorded a deferred tax liability as a result of purchase accounting associated with SNAPin. This results in an increase of the net deferred tax asset and a reduction of the corresponding valuation allowance in the consolidated group. Therefore, there is no impact on goodwill related to the deferred tax liability.
- (c) We assumed significant legal performance obligations related to acquired customer contracts. We estimate the fair market value of the obligations based on expected costs we will incur to fulfill the obligation plus a normal profit margin. The fair value of the legal performance obligations remaining to be delivered on these customer contracts was approximately \$53.4 million and the remaining cash to be collected on these contracts was approximately \$25.9 million at the date of acquisition.

We assumed vested and unvested stock options that were converted into options to purchase 1,258,708 shares of our common stock and restricted stock units that were converted into 299,446 shares of our common stock. The fair value of the assumed vested stock options and restricted stock units as of the date of acquisition are included in the purchase price above. The fair value of the assumed vested stock options was calculated under the Black-Scholes option pricing model, with the following weighted-average assumptions: dividend yield of 0.0%; expected volatility of 55.5%; average risk-free interest rate of 2.8%; and an expected term of 4.8 years. Assumed unvested stock options and restricted stock units as of the date of acquisition will be recorded as stock-based compensation expense over the requisite service period as disclosed in Note 17.

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The following are the identifiable intangible assets acquired and their respective weighted average useful lives (dollars in thousands):

|                               | <u>Amount</u>   | <u>Weighted<br/>Average<br/>Life<br/>(In years)</u> |
|-------------------------------|-----------------|---|
| Customer relationships        | \$ 21,200       | 10.8  |
| Core and completed technology | 39,000          | 10.0  |
| Non-compete agreements        | 700             | 4.0   |
| Total                         | <u>\$60,900</u> |   |

***Other Fiscal 2009 Acquisitions***

During fiscal 2009, we acquired an additional six businesses primarily to expand our product offerings and enhance our technology base. The results of operations of these acquisitions are included in our consolidated results from their respective acquisition dates. The total consideration for these acquisitions was approximately \$166.5 million. The gross purchase price consisted of the issuance of 6.4 million shares of our common stock valued at \$80.9 million, \$76.8 million in cash and \$8.8 million for transaction costs. In allocating the total purchase consideration for these acquisitions based on estimated fair values, we have recorded \$68.2 million of goodwill, \$71.9 million of identifiable intangible assets, and \$26.3 million in net assets (resulting primarily from cash assumed; acquired unbilled receivables, net of liabilities assumed including contingencies; deferred income taxes; and restructuring). We have assumed a \$5.0 million tax contingency established for uncertain foreign tax positions relating to one of the acquisitions. Intangible assets acquired included primarily core and completed technology and customer relationships with weighted average useful lives of 9.5 years.

**4. Pro Forma Results (Unaudited)**

The following table shows unaudited pro forma results of operations as if we had acquired SpinVox, Equitrac and SVOX on October 1, 2009 (dollars in thousands):

|                             | <u>2011</u>  | <u>2010</u>  |
|-----------------------------|--------------|--------------|
| Revenue                     | \$ 1,374,774 | \$ 1,190,615 |
| Net income (loss)           | \$ 2,425     | \$ (56,734)  |
| Net income (loss) per share | \$ 0.01      | \$ (0.20)    |

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

**5. Contingent Acquisition Payments**

Contingent acquisition payment arrangements related to our acquisition of Snapin in 2009 are discussed above in Note 3. In addition, we remain a party to certain contingent consideration arrangements relative to acquisitions completed in other fiscal years. Those arrangements are discussed below.

***Earn-out Payments***

For business combinations occurring subsequent to the adoption of ASC 805 in fiscal 2010, the fair value of any contingent consideration is established at the acquisition date and included in the total purchase price. The contingent consideration is then adjusted to fair value as an increase or decrease in current earnings in each

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

reporting period. Contingent consideration related to acquisitions prior to our adoption of ASC 805 have been and will continue to be recorded as additional purchase price when the contingency is resolved and additional consideration is attributable.

In connection with an immaterial acquisition during fiscal 2010, we agreed to make contingent earn-out payments of up to \$2.5 million, payable in stock, upon the achievement of certain financial targets for calendar year 2010 and 2011. At the acquisition date, we recorded \$1.0 million as the fair value of the contingent consideration. For the years ended September 30, 2011 and 2010, we have recorded (expense) income of \$(1.1) million and \$0.3 million as fair value adjustments included in acquisition-related costs, net in our consolidated statement of operations. In September 2011, we paid \$0.5 million in cash and stock to the former shareholders related to the calendar year 2010 earn-out.

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

In connection with our acquisition of Commissure, Inc. (“Commissure”) in September 2007, we agreed to make contingent earn-out payments of up to \$8.0 million, payable in stock, or cash, solely at our discretion, upon the achievement of certain financial targets for the fiscal years 2008, 2009 and 2010. In February 2011, we paid \$1.0 million upon determination of the final earn-out achievement and recorded the payment as additional purchase price allocated to goodwill.

In connection with our acquisition of Phonetic Systems Ltd. (“Phonetic”) in February 2005, we agreed to make contingent earn-out payments of \$35 million upon achievement of certain established financial and performance targets, in accordance with the merger agreement. In December 2009, we paid \$11.3 million to the former shareholders of Phonetic in final settlement of the contingent earn-out provisions and recorded the amount paid as additional purchase price related to the Phonetic acquisition.

***Escrow and Holdback Arrangements***

In connection with certain of our acquisitions, we have placed either cash or shares of our common stock in escrow to satisfy any indemnification claims we may have. If no claims are made, the escrowed amounts will be released to the former shareholders of the acquired companies. Historically, in accordance with the previous accounting guidance in Statement of Financial Accounting Standard No. 141, *Business Combinations* (“SFAS 141”), we could not make a determination, beyond a reasonable doubt, whether the escrow would become payable to the former shareholders of these companies until the escrow period had expired. Accordingly these amounts were treated as contingent purchase price until it was determined that the escrow was payable, at which time the escrowed amounts would be recorded as additional purchase price and allocated to goodwill. Under the revised accounting guidance of ASC 805, escrow payments are generally considered part of the initial purchase consideration and accounted for as goodwill.

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



NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

6. Goodwill and Intangible Assets

Effective in the fourth quarter of fiscal 2011, we changed our reporting segments to four reportable segments. The changes in the carrying amount of goodwill for our four reportable segments for fiscal years 2011 and 2010 were as follows (dollars in thousands):

|  | Healthcare | Mobile and Consumer | Enterprise | Imaging    | Total        |
|--|------------|---------------------|------------|------------|--------------|
| Balance as of September 30, 2009       | \$ 613,973 | \$ 786,738          | \$ 442,701 | \$ 47,591  | \$ 1,891,003 |
| Goodwill acquired                      | 28,681     | 123,867             | 2,528      | —          | 155,076      |
| Escrow amounts released(1)             | —          | —                   | —          | 3,700      | 3,700        |
| Purchase accounting adjustments(2)     | (1,940)    | (405)               | 19,509     | 12,947     | 30,111       |
| Effect of foreign currency translation | (3,605)    | 690                 | 1,182      | (214)      | (1,947)      |
| Balance as of September 30, 2010       | \$ 637,109 | \$ 910,890          | \$ 465,920 | \$ 64,024  | \$ 2,077,943 |
| Goodwill acquired                      | 35,128     | 109,747             | 39,792     | 87,439     | 272,106      |
| Escrow amounts released(1)             | —          | —                   | —          | 5,150      | 5,150        |
| Purchase accounting adjustments        | 460        | (1,646)             | 402        | —          | (784)        |
| Effect of foreign currency translation | (48)       | (576)               | (5,874)    | (37)       | (6,535)      |
| Balance as of September 30, 2011       | \$ 672,649 | \$ 1,018,415        | \$ 500,240 | \$ 156,576 | \$ 2,347,880 |

- (1) In accordance with the prior guidance in SFAS 141 discussed in Note 5 above, we recorded the release of escrow amounts upon the expiration of the escrow periods as additional purchase price and allocated to goodwill.
- (2) Goodwill adjustments for our Enterprise segment in fiscal 2010 included an \$11.3 million increase related to the Phonetic earn-out payment and an \$8.3 million increase related to the SNAPin earn-out liability upon determination of the final earn-out achievement. The goodwill adjustment for our Imaging segment in fiscal 2010 included a \$13.1 million increase in goodwill due to the change in the fair value estimate of acquired intangible assets from our acquisition of eCopy in fiscal 2009.

Intangible assets consist of the following as of September 30, 2011 and 2010, which includes \$130.3 million and \$151.0 million of licensed technology, respectively (dollars in thousands):

|                                    | September 30, 2011    |                          |                     | Weighted Average Remaining Life (Years) |
|------------------------------------|-----------------------|--------------------------|---------------------|---|
|                                    | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |   |
| Customer relationships             | \$ 727,284            | \$ (302,979)             | \$ 424,305          | 8.7                                     |
| Technology and patents             | 428,597               | (167,838)                | 260,759             | 5.9                                     |
| Trade names, trademarks, and other | 68,560                | (23,337)                 | 45,223              | 9.6                                     |
| Non-competition agreements         | 2,769                 | (1,479)                  | 1,290               | 2.2                                     |
| Total                              | \$ 1,227,210          | \$ (495,633)             | \$ 731,577          | 7.7                                     |

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

|                                    | September 30, 2010       |                             |                        |   |
|------------------------------------|--------------------------|-----------------------------|------------------------|---|
|                                    | Gross Carrying<br>Amount | Accumulated<br>Amortization | Net Carrying<br>Amount | Weighted Average<br>Remaining<br>Life (Years) |
| Customer relationships             | \$ 597,672               | \$ (231,079)                | \$ 366,593             | 7.0   |
| Technology and patents             | 389,508                  | (124,607)                   | 264,901                | 8.6   |
| Trade names, trademarks, and other | 38,798                   | (14,047)                    | 24,751                 | 4.4   |
| Non-competition agreements         | 5,068                    | (3,248)                     | 1,820                  | 2.0   |
| Subtotal                           | 1,031,046                | (372,981)                   | 658,065                | 7.5   |
| Trade name, indefinite life        | 27,800                   | —                           | 27,800                 | n/a   |
| Total                              | \$ 1,058,846             | \$ (372,981)                | \$ 685,865             |   |

In fiscal 2010 we purchased patents and licenses totaling \$45 million, which is included with the technology and patents category. We made payments to third parties of both cash and shares of our common stock in connection with these acquisitions. A total of 2,180,600 shares of our common stock were issued subject to price guarantees as described further in Note 11. The weighted average useful life related to these acquired assets is 10 years.

In June 2009, we entered into a joint marketing and selling agreement with a third party and paid \$7.0 million in consideration of the arrangement. We have capitalized the payment as an intangible asset, included in the trade names, trademarks, and other category above, and assigned a useful life of 3 years, commensurate with the legal term of the rights in the arrangement. In addition to the \$7.0 million paid in June 2009, we issued 879,567 shares of our common stock valued at \$13.0 million in December 2009 upon the third party meeting certain performance criteria under the agreement. The additional \$13.0 million was capitalized in fiscal 2010 and classified in the same manner as the initial \$7.0 million payment.

Amortization expense for acquired technology and patents is included in the cost of revenue from amortization of intangible assets in the accompanying statements of operations and amounted to \$55.1 million, \$47.8 million and \$38.4 million in fiscal 2011, 2010 and 2009, respectively. Amortization expense for customer relationships, trade names, trademarks, and other, and non-competition agreements is included in operating expenses and amounted to \$88.2 million, \$87.8 million and \$77.0 million in fiscal 2011, 2010 and 2009, respectively. Estimated amortization expense for each of the five succeeding years as of September 30, 2011, is as follows (dollars in thousands):

| Year Ending September 30, | Cost of<br>Revenue | Other<br>Operating<br>Expenses | Total      |
|---------------------------|--------------------|--------------------------------|------------|
| 2012                      | \$ 55,311          | \$ 86,376                      | \$ 141,687 |
| 2013                      | 48,896             | 73,705                         | 122,601    |
| 2014                      | 39,631             | 64,201                         | 103,832    |
| 2015                      | 35,949             | 55,358                         | 91,307     |
| 2016                      | 29,693             | 45,996                         | 75,689     |
| Thereafter                | 51,279             | 145,182                        | 196,461    |
| Total                     | \$260,759          | \$ 470,818                     | \$ 731,577 |

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**7. Accounts Receivable**

Accounts receivable, excluding acquired unbilled accounts receivable, consisted of the following (dollars in thousands):

|  | <u>September 30,</u><br><u>2011</u> | <u>September 30,</u><br><u>2010</u> |
|--|-------------------------------------|-------------------------------------|
| Trade accounts receivable              | \$ 280,620                          | \$ 214,861                          |
| Unbilled accounts receivable           | 11,506                              | 15,856                              |
| Gross accounts receivable              | 292,126                             | 230,717                             |
| Less — allowance for doubtful accounts | (5,707)                             | (6,301)                             |
| Less — allowance for sales returns     | (6,233)                             | (6,829)                             |
| Accounts receivable, net               | <u>\$ 280,186</u>                   | <u>\$ 217,587</u>                   |

**8. Land, Building and Equipment, Net**

Land, building and equipment, net at September 30, 2011 and 2010 were as follows (dollars in thousands):

|                                   | <u>Useful Life</u><br><u>(In years)</u> | <u>September 30,</u><br><u>2011</u> | <u>September 30,</u><br><u>2010</u> |
|-----------------------------------|---|-------------------------------------|-------------------------------------|
| Land                              | —                                       | \$ 2,400                            | \$ 2,400                            |
| Building                          | 30                                      | 5,432                               | 5,363                               |
| Machinery and equipment           | 3-5                                     | 13,048                              | 5,786                               |
| Computers, software and equipment | 3-5                                     | 136,204                             | 108,278                             |
| Leasehold improvements            | 2-7                                     | 19,315                              | 15,659                              |
| Furniture and fixtures            | 5                                       | 12,540                              | 10,759                              |
| Construction in progress          | n/a                                     | 2,695                               | 662                                 |
| Subtotal                          |   | 191,634                             | 148,907                             |
| Less: accumulated depreciation    |   | (113,416)                           | (86,824)                            |
| Land, building and equipment, net |   | <u>\$ 78,218</u>                    | <u>\$ 62,083</u>                    |

Depreciation expense, associated with building and equipment, for fiscal 2011, 2010 and 2009 was \$27.6 million, \$21.6 million and \$18.7 million, respectively.

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**9. Accrued Expenses and Other Current Liabilities**

Accrued expenses consisted of the following (dollars in thousands):

|                                     | September 30,<br>2011 | September 30,<br>2010 |
|-------------------------------------|-----------------------|-----------------------|
| Compensation                        | \$ 97,929             | \$ 56,047             |
| Sales and marketing incentives(a)   | 16,253                | 40,780                |
| Professional fees                   | 11,975                | 9,908                 |
| Sales and other taxes payable       | 9,876                 | 5,211                 |
| Cost of revenue related liabilities | 8,698                 | 10,028                |
| Accrued business combination costs  | 8,275                 | 10,197                |
| Acquisition costs and liabilities   | 8,414                 | 4,970                 |
| Income taxes payable                | 4,240                 | 4,357                 |
| Other                               | 10,414                | 10,123                |
| Total                               | <u>\$ 176,074</u>     | <u>\$ 151,621</u>     |

(a) The decrease in accrued sales and marketing incentives was driven by an €18.0 million (\$23.4 million equivalent) payment in December 2010 for a fixed obligation assumed in connection with our acquisition of SpinVox. The related €18.0 million of restricted cash was placed in an irrevocable standby letter of credit account at the end of fiscal year 2010 and was released upon satisfaction of the liability in December 2010. At September 30, 2011, we have an additional €5.0 million (\$6.8 million equivalent) of restricted cash that has been placed in an irrevocable standby letter of credit for a related liability.

**10. Credit Facilities and Debt**

At September 30, 2011 and 2010, we had the following borrowing obligations (dollars in thousands):

|   | September 30,<br>2011 | September 30,<br>2010 |
|---|-----------------------|-----------------------|
| 2.75% Convertible Debentures due 2027, net of unamortized discount of \$27.4 million and \$36.3 million, respectively | \$ 222,557            | \$ 213,654            |
| Credit Facility   | 636,941               | 643,563               |
| Obligations under capital leases and other  | 427                   | 1,561                 |
| Total long-term debt  | 859,925               | 858,778               |
| Less: current portion   | 6,905                 | 7,764                 |
| Non-current portion of long-term debt   | <u>\$ 853,020</u>     | <u>\$ 851,014</u>     |

The estimated fair value of our long-term debt approximated \$937.8 million and \$902.2 million at September 30, 2011 and 2010, 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 issues will continue to vary each period based on fluctuations in market interest rates, as well as changes to our credit ratings. The term loan portion of our Credit Facility is traded and the fair values are based upon traded prices as of the reporting dates. The fair values of the 2.75% Convertible Debentures due 2027 at each respective reporting date were estimated using the averages of the September 30, 2011 and September 30, 2010 bid and ask trading quotes. We had no outstanding balance on the revolving credit line portion of our Credit Facility. Our capital lease obligations and other debt are not traded and the fair values of these instruments are assumed to approximate their carrying values as of September 30, 2011 and September 30, 2010.

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***2.75% Convertible Debentures due 2027***

On August 13, 2007, we issued \$250 million of 2.75% convertible senior debentures due in 2027 (“the 2027 Debentures”) in a private placement to Citigroup Global Markets Inc. and Goldman, Sachs & Co. Total proceeds, net of debt discount of \$7.5 million and deferred debt issuance costs of \$1.1 million, were \$241.4 million. The 2027 Debentures bear an interest rate of 2.75% per annum, payable semi-annually in arrears beginning on February 15, 2008, and mature on August 15, 2027 subject to the right of the holders of the 2027 Debentures to require us to redeem the 2027 Debentures on August 15, 2014, 2017 and 2022. In accordance with ASC 470-20, *Debt with Conversion and Other Options*, the difference of \$54.7 million between the fair value of the liability component of the 2027 Debentures and the net proceeds on the date of issuance have been recorded as additional paid-in-capital and as debt discount. The aggregate debt discount is being amortized to interest expense using the effective interest rate method through August 2014. As of September 30, 2011 and 2010, the ending unamortized discount was \$27.4 million and \$36.3 million, respectively, and the ending unamortized deferred debt issuance costs were \$0.3 million and \$0.4 million, respectively. The 2027 Debentures are general senior unsecured obligations, ranking equally in right of payment to all of our existing and future unsecured, unsubordinated indebtedness and senior in right of payment to any indebtedness that is contractually subordinated to the 2027 Debentures. The 2027 Debentures are effectively subordinated to our secured indebtedness to the extent of the value of the collateral securing such indebtedness and are structurally subordinated to indebtedness and other liabilities of our subsidiaries. If converted, the principal amount of the 2027 Debentures is payable in cash and any amounts payable in excess of the \$250 million principal amount, will (based on an initial conversion rate, which represents an initial conversion price of \$19.47 per share, subject to adjustment) be paid in cash or shares of our common stock, at our election, only in the following circumstances and to the following extent: (i) on any date during any fiscal quarter beginning after September 30, 2007 (and only during such fiscal quarter) if the closing sale price of our common stock was more than 120% 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) during the five consecutive business-day period following any five consecutive trading-day period in which the trading price for \$1,000 principal amount of the 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; (iii) upon the occurrence of specified corporate transactions, as described in the indenture for the 2027 Debentures; and (iv) at the option of the holder at any time on or after February 15, 2027. Additionally, we may redeem the 2027 Debentures, in whole or in part, on or after August 20, 2014 at par plus accrued and unpaid interest; each holder shall have the right, at such holder’s option, to require us to repurchase all or any portion of the 2027 Debentures held by such holder on August 15, 2014, August 15, 2017 and August 15, 2022. Upon conversion, we will pay the principal amount in cash and any amounts payable in excess of the \$250 million principal amount will be paid in cash or shares of our common stock, at our election. If we undergo a fundamental change (as described in the indenture for the 2027 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 debentures to be purchased plus any accrued and unpaid interest, including any additional interest to, but excluding, the repurchase date. As of September 30, 2011, no conversion triggers were met. If the conversion triggers were met, we could be required to repay all or some of the principal amount in cash prior to the maturity date.

***Credit Facility***

We entered into a credit facility which consists of a \$75 million revolving credit line including letters of credit, a \$355 million term loan entered into on March 31, 2006, a \$90 million term loan entered into on April 5, 2007 and a \$225 million term loan entered into on August 24, 2007 (the “Credit Facility”). In July 2011, we entered into agreements to amend and restate our existing Credit Facility. Of the approximately \$638.5 million remaining Term Loan, lenders representing \$493.2 million elected to extend the maturity date by three years to March 31, 2016. The remaining \$145.3 million in term loans are due March 2013. In addition, lenders participating in the revolving credit facility have chosen to extend the maturity date by three years to March 31, 2015. As of September 30, 2011,

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

\$636.9 million remained outstanding under the term loans, there were \$15.4 million of letters of credit issued under the revolving credit line and there were no other outstanding borrowings under the revolving credit line.

The Credit Facility contains covenants, including, among other things, covenants that restrict our ability and those of our subsidiaries to incur certain additional indebtedness, create or permit liens on assets, enter into sale-leaseback transactions, make loans or investments, sell assets, make certain acquisitions, pay dividends, or repurchase stock. The agreement also contains events of default, including failure to make payments of principal or interest, failure to observe covenants, breaches of representations and warranties, defaults under certain other material indebtedness, failure to satisfy material judgments, a change of control and certain insolvency events. As of September 30, 2011, we were in compliance with the covenants under the Credit Facility.

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

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

- (a) The margin is determined based on our leverage ratio and credit rating at the date the interest rates are reset on the Term Loans.
- (b) The margin is determined based on our leverage ratio and credit rating at the date the interest rates are reset on the revolving credit line.

At September 30, 2011 the applicable margins were 1.75%, with an effective rate of 1.98%, on the remaining balance of \$145.0 million maturing in March 2013 and 3.00%, with an effective rate of 3.23%, on the remaining balance of \$492.0 million maturing in March 2016. We are required to pay a commitment fee for unutilized commitments under the revolving credit facility at a rate ranging from 0.375% to 0.50% per annum, based upon our leverage ratio. As of September 30, 2011, the commitment fee rate was 0.375%.

We capitalized debt issuance costs related to the Credit Facility and are amortizing the costs to interest expense using the effective interest rate method, through March 2013 for costs associated with the unextended portion of the term loan, through March 2015 for costs associated with the revolving credit facility and through March 2016 for the remainder of the balance. As of September 30, 2011 and 2010, the ending unamortized deferred financing fees were \$5.8 million and \$5.8 million, respectively, and are included in other assets in the accompanying consolidated balance sheet.

The Credit Facility amendment extended the payment terms on a portion of the loan. Principal is due in quarterly installments of 0.25% of the then outstanding balance through the original maturity date of March 2013 for \$145.3 million, representing the portion of the loan that was not extended. Principal payments on the extended loan of \$493.2 are due in quarterly installments of 0.25% of the then outstanding balance through March 2016, at which point the remaining balance becomes due. In addition, an annual excess cash flow sweep, as defined in the Credit Facility, is payable in the first quarter of each fiscal year, based on the excess cash flow generated in the previous fiscal year. We have not generated excess cash flows in any period and no additional payments are required. We will continue to evaluate the extent to which a payment is due in the first quarter of future fiscal years based on excess cash flow generation. At the current time, we are unable to predict the amount of the outstanding principal, if any, that may be required to be repaid in future fiscal years pursuant to the excess cash flow sweep provisions. Any term loan borrowings not paid through the baseline repayment, the excess cash flow sweep, or any other mandatory or optional payments that we may make, will be repaid upon maturity. If only the baseline

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

repayments are made, the annual aggregate principal amount of the term loans repaid would be as follows (dollars in thousands):

| Year Ending September 30, | Amount           |
|---------------------------|------------------|
| 2012                      | \$ 6,346         |
| 2013                      | 148,385          |
| 2014                      | 4,804            |
| 2015                      | 4,756            |
| 2016                      | 472,650          |
| Total                     | <u>\$636,941</u> |

Our obligations under the Credit Facility are unconditionally guaranteed by, subject to certain exceptions, each of our existing and future direct and indirect wholly-owned domestic subsidiaries. The Credit Facility and the guarantees thereof are secured by first priority liens and security interests in the following: 100% of the capital stock of substantially all of our domestic subsidiaries and 65% of the outstanding voting equity interests and 100% of the non-voting equity interests of first-tier foreign subsidiaries, all our material tangible and intangible assets and those of the guarantors, and any present and future intercompany debt. The Credit Facility also contains provisions for mandatory prepayments of outstanding term loans upon receipt of the following, and subject to certain exceptions: 100% of net cash proceeds from asset sales, 100% of net cash proceeds from issuance or incurrence of debt, and 100% of extraordinary receipts. We may voluntarily prepay borrowings under the Credit Facility without premium or penalty other than breakage costs, as defined with respect to LIBOR-based loans.

**11. Financial Instruments and Hedging Activities**

***Cash Flow Hedges***

*Forward Currency Contracts*

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

|  | Notional Value |                 | Aggregate Cumulative<br>Unrealized Gains |               |
|--|----------------|-----------------|--|---------------|
|  | 2011           | 2010            | 2011                                     | 2010          |
| Canadian dollars                               | \$375          | \$ 13,004       | \$ 9                                     | \$ 286        |
| Hungarian forints                              | 128            | 4,564           | 6  | 443           |
| Total contracts designated as cash flow hedges | <u>\$ 503</u>  | <u>\$17,568</u> | <u>\$ 15</u>                             | <u>\$ 729</u> |

***Other Derivatives not Designated as Hedges***

*Forward Currency Contracts*

We operate our business in countries throughout the world and transact business in various foreign currencies. Our foreign currency exposures typically arise from transactions denominated in currencies other than the local functional currency of our operations. During fiscal 2011, we commenced a program that primarily utilizes foreign currency forward contracts to offset these risks associated with the effect of certain foreign currency exposures. We commenced this program 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

## NUANCE COMMUNICATIONS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

foreign currency transactions. Generally, we enter into contracts for less than 90 days, and at September 30, 2011 we had outstanding contracts with a total notional value of \$75.7 million.

We have not designated these forward contracts as hedging instruments pursuant to ASC 815, *Derivatives and Hedging* and accordingly, we recorded the fair value of these contracts at the end of each reporting period in our consolidated balance sheet, with changes in the fair value recorded in earnings as other income, net in our consolidated statement of operations. During the year ended September 30, 2011, we recorded losses of \$2.3 million associated with these contracts.

During fiscal 2010, we entered into a euro 18 million foreign currency contract to offset the foreign currency exposure on a fixed obligation assumed in connection with our acquisition of SpinVox in December 2009. The contract matured in December 2010 and the realized gain was recorded in other income, net and was offset by the corresponding realized loss on the settlement of the obligation.

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

*Security Price Guarantees*

From time to time we enter into agreements that allow us to issue shares of our common stock as part or all of the consideration related to partnering and technology acquisition activities. Generally these shares are issued subject to security price guarantees which are accounted for as derivatives. We have determined that these instruments would not be considered equity instruments if they were freestanding. The security price guarantees require payment from either us to a third party, or from a third party to us, based upon the difference between the price of our common stock on the issue date and an average price of our common stock approximately six months following the issue date. Changes in the fair value of these security price guarantees are reported in earnings in each period as other income, net. During the years ended September 30, 2011 and 2010, we recorded \$13.2 million and \$4.0 million, respectively of gains associated with these contracts and received net cash payments totaling \$9.4 million and \$7.3 million, respectively, upon the settlement of agreements during the year.

The following is a summary of the outstanding shares subject to security price guarantees at September 30, 2011 (dollars in thousands):

| <u>Issue Date</u> | <u>Number of Shares<br/>Issued</u> | <u>Settlement Date</u> | <u>Total Value of Shares<br/>on Issue Date</u> |
|-------------------|------------------------------------|------------------------|--|
| April 1, 2011     | 127,878                            | October 1, 2011        | \$ 2,500                                       |
| June 25, 2011     | 123,275                            | December 25, 2011      | \$ 2,500                                       |
| August 18, 2011   | 1,023,360                          | February 18, 2012      | \$ 18,400                                      |



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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

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

| Description  | Balance Sheet Classification                   | Fair Value         |                    |
|--|--|--------------------|--------------------|
|  |  | September 30, 2011 | September 30, 2010 |
| <b>Derivatives Not Designated as Hedges:</b>                     |  |                    |                    |
| Foreign currency contracts                                       | Prepaid expenses and other current assets      | \$ —               | \$ 767             |
| Foreign currency contracts                                       | Accrued expenses and other current liabilities | (1,025)            | —                  |
| Security Price Guarantees  | Prepaid expenses and other current assets      | 2,781              | —                  |
| Security Price Guarantees  | Accrued expenses and other current liabilities | —                  | (982)              |
| Net asset (liability) value of non-hedged derivative instruments |  | <u>\$ 1,756</u>    | <u>\$ (215)</u>    |
| <b>Derivatives Designated as Hedges:</b>                         |  |                    |                    |
| Foreign currency contracts                                       | Prepaid expenses and other current assets      | \$ 15              | \$ 729             |
| Interest rate swaps  | Accrued expenses and other current liabilities | —                  | (503)              |
| Net asset value of hedged derivative instruments                 |  | <u>\$ 15</u>       | <u>\$ 226</u>      |

The following tables summarize the activity of derivative instruments for the fiscal 2011 and 2010 (dollars in thousands):

**Derivatives Not Designated as Hedges for the Fiscal Year Ended September 30**

|                            | Location of Gain (Loss) Recognized in Income | Amount of Gain (Loss) Recognized in Income |          |
|----------------------------|--|--|----------|
|                            |  | 2011                                       | 2010     |
| Foreign currency contracts | Other income (expense), net                  | \$ (2,332)                                 | \$ 767   |
| Security price guarantees  | Other income (expense), net                  | \$ 13,230                                  | \$ 4,026 |

**Derivatives Designated as Hedges for the Fiscal Year Ended September 30**

|                            | Amount of Gain (Loss) Recognized in OCI |          | Location and Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) |                    |
|----------------------------|---|----------|--|--------------------|
|                            | 2011                                    | 2010     | 2011   | 2010               |
| Foreign currency contracts | \$ 475                                  | \$ 734   | Other income (expense), net  | \$ 1,189    \$ (5) |
| Interest rate swaps        | \$ —                                    | \$ 3,479 | Other income (expense), net  | \$ (503)    \$ —   |

**12. 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

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

which we would transact and consider assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of nonperformance.

ASC 820, *Fair Value Measures and Disclosures*, establishes a value hierarchy based on three levels of inputs, of which the first two are considered observable and the third is considered unobservable:

- *Level 1.* Quoted prices for identical assets or liabilities in active markets which we can access.
- *Level 2.* Observable inputs other than those described as Level 1.
- *Level 3.* Unobservable inputs.

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

|  | September 30, 2011 |                  |                 |                   |
|--|--------------------|------------------|-----------------|-------------------|
|  | Level 1            | Level 2          | Level 3         | Total             |
| <b>Assets:</b>                             |                    |                  |                 |                   |
| Money market funds(a)                      | \$ 258,001         | \$ —             | \$ —            | \$ 258,001        |
| Time deposits(b)                           | —                  | 49,832           | —               | 49,832            |
| US government agency securities(a)         | 1,000              | —                | —               | 1,000             |
| Marketable securities, \$31,256 at cost(b) | —                  | 31,244           | —               | 31,244            |
| Foreign currency exchange contracts(b)     | —                  | 15               | —               | 15                |
| Security price guarantees(c)               | —                  | 2,781            | —               | 2,781             |
| Total assets at fair value                 | <u>\$ 259,001</u>  | <u>\$ 83,872</u> | <u>\$ —</u>     | <u>\$ 342,873</u> |
| <b>Liabilities:</b>                        |                    |                  |                 |                   |
| Foreign currency exchange contracts(b)     | —                  | 1,025            | —               | 1,025             |
| Contingent earn-out(d)                     | —                  | —                | 1,358           | 1,358             |
| Total liabilities at fair value            | <u>\$ —</u>        | <u>\$ 1,025</u>  | <u>\$ 1,358</u> | <u>\$ 2,383</u>   |

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

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

- (b) The fair value of our time deposits, marketable securities and foreign currency exchange contracts is based on the most recent observable inputs for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active or are directly or indirectly observable.
- (c) The fair values of the security price guarantees are determined using a modified Black-Scholes model, derived from observable inputs such as US treasury interest rates, our common stock price, and the volatility of our common stock. The valuation model values both the put and call components of the guarantees simultaneously, with the net value of those components representing the fair value of each instrument.
- (d) The fair value of our contingent consideration arrangement is determined based on the Company's evaluation as to the probability and amount of any earn-out that will be achieved based on expected future performance by the acquired entity, as well as our common stock price since the contingent consideration arrangement is payable in shares of our common stock. Refer to Note 5 for additional information.
- (e) The fair values of the interest rate swaps are estimated using discounted cash flow analyses that factor in observable market inputs such as LIBOR — based yield curves, forward rates, and credit spreads.

The following table provides a summary of changes in fair value of our Level 3 financial instruments for the years ended September 30, 2011 and 2010 (dollars in thousands):

|   | <u>Amount</u>   |
|---|-----------------|
| Balance as of October 1, 2009                         | \$ —            |
| Earn-out liability established at time of acquisition | 1,034           |
| Charges (credits) to acquisition-related costs, net   | <u>(310)</u>    |
| Balance as of September 30, 2010                      | 724             |
| Payments  | (455)           |
| Charges (credits) to acquisition-related costs, net   | 1,089           |
| Balance as of September 30, 2011                      | <u>\$ 1,358</u> |

***Items Measured at Fair Value on a Nonrecurring Basis***

In the fourth quarter of fiscal 2011, we performed our annual impairment test for our goodwill and indefinite lived intangible asset. Our indefinite-lived intangible asset is the Dictaphone trade name used in our Healthcare segment which was acquired in March 2006. A change in marketing strategy became effective in the fourth quarter of fiscal 2011 that will result in rebranding a number of our Healthcare offerings, and we will no longer be using the Dictaphone trade name for any new product offerings. This new marketing strategy caused us to update our revenue forecasts used in estimating the fair value of the trade name. Because the Dictaphone trade name will no longer be used for new product offerings, we adjusted the future revenues associated with the Dictaphone trade name in estimating the fair value of the asset. We calculated the fair value of the Dictaphone trade name using a discounted cash flow model based on the adjusted forecast for the existing customer base using the historical products that continue to use the existing trade name designation. In performing our analysis, we used assumptions that we believe a market participant would utilize in valuing the trade name. We determined the fair value of the Dictaphone trade name to be \$16.1 million with an estimated remaining useful life of fifteen years and recorded an impairment of \$11.7 million (\$1.2 million, net of taxes) in restructuring and other charges, net.

**13. Accrued Business Combination Costs**

We have, in connection with certain of our business combinations, incurred restructuring costs. Restructuring costs are typically comprised of severance costs, costs of consolidating duplicate facilities and contract termination costs. In accordance with our adoption of ASC 805 in fiscal 2010, restructuring expenses are recognized at the date of acquisition if such restructuring costs meet the recognition criteria in ASC 420, *Exit or Disposal Cost Obligations*. Prior to our adoption of ASC 805, restructuring expenses were recognized based upon plans that

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

were committed to by management at the date of acquisition, but were generally subject to refinement during the purchase price allocation period (generally within one year of the acquisition date). In addition to plans resulting from the business combination, previous acquisitions have included companies which have established liabilities relating to lease exit costs as a result of their previous restructuring activities. Regardless of the origin of the lease exit costs, we are required to make assumptions relating to sublease terms, sublease rates and discount rates. We base our estimates and assumptions on the best information available at the time of the obligation having arisen. These estimates are reviewed and revised as facts and circumstances dictate, with any changes being recorded to goodwill (for acquisitions completed prior to October 2009) or restructuring and other charges, net. Changes in these estimates could have a material effect on the amount accrued on the balance sheet.

In connection with the acquisitions of SpeechWorks International, Inc. in August 2003 and Former Nuance in September 2005, we assumed two individually significant lease obligations that were abandoned prior to the acquisition dates. These obligations expire in 2016 and 2012, respectively, and the fair value of the obligations, net of estimated sublease income, was recognized as a liability assumed by us in the allocation of the final purchase price. The net payments have been discounted in calculating the fair value of these obligations, and the discount is being accreted through the term of the lease. Cash payments net of sublease receipts are presented as cash used in financing activities on the consolidated statements of cash flows.

Additionally, prior to the adoption of ASC 805, we implemented restructuring plans to eliminate duplicate facilities, personnel or assets in connection with business combinations. These costs were recognized as liabilities assumed, and accordingly are included in the allocation of the purchase price, generally resulting in an increase to the recorded amount of the goodwill.

The activity for the years ended September 30, 2011, 2010 and 2009, relating to all facilities and personnel recorded in accrued business combination costs, is as follows (dollars in thousands):

|   | <u>Facilities</u> | <u>Personnel</u> | <u>Total</u>     |
|---|-------------------|------------------|------------------|
| Balance at October 1, 2008                      | \$ 41,178         | \$ —             | \$ 41,178        |
| Charged to goodwill                             | 2,689             | 6,391            | 9,080            |
| Charged to restructuring and other charges, net | 111               | —                | 111              |
| Charged to interest expense                     | 1,677             | —                | 1,677            |
| Cash payments, net of sublease receipts         | <u>(11,104)</u>   | <u>(3,894)</u>   | <u>(14,998)</u>  |
| Balance at September 30, 2009                   | 34,551            | 2,497            | 37,048           |
| Charged to goodwill                             | (15)              | (759)            | (774)            |
| Charged to restructuring and other charges, net | (769)             | —                | (769)            |
| Charged to interest expense                     | 1,241             | —                | 1,241            |
| Cash payments, net of sublease receipts         | <u>(11,137)</u>   | <u>(1,579)</u>   | <u>(12,716)</u>  |
| Balance at September 30, 2010                   | 23,871            | 159              | 24,030           |
| Charged to restructuring and other charges, net | 12                | (100)            | (88)             |
| Charged to interest expense                     | 832               | —                | 832              |
| Cash payments, net of sublease receipts         | <u>(11,760)</u>   | <u>(59)</u>      | <u>(11,819)</u>  |
| Balance at September 30, 2011                   | <u>\$ 12,955</u>  | <u>\$ —</u>      | <u>\$ 12,955</u> |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

|              | <u>September 30,</u><br><u>2011</u> | <u>September 30,</u><br><u>2010</u> |
|--------------|-------------------------------------|-------------------------------------|
| Reported as: |                                     |                                     |
| Current      | \$ 8,275                            | \$ 10,197                           |
| Long-term    | 4,680                               | 13,833                              |
| Total        | <u>\$ 12,955</u>                    | <u>\$ 24,030</u>                    |

**14. Restructuring and Other Charges, net**

*Fiscal 2011*

For fiscal 2011, we recorded net restructuring and other charges of \$23.0 million, which consisted primarily of an \$11.7 million impairment charge related to our Dictaphone trade name resulting from a recent change in our Healthcare marketing strategy under which we plan to consolidate our brands and will no longer be using the Dictaphone trade name in our new product offerings. In addition, we recorded a \$9.1 million charge related to the elimination of approximately 200 personnel across multiple functions primarily to eliminate duplicative positions as a result of businesses acquired during the year and a \$1.9 million charge related to the elimination or consolidation of excess facilities.

*Fiscal 2010*

For fiscal 2010, we recorded net restructuring and other charges of \$18.7 million, which consisted primarily of \$9.6 million related to the elimination of approximately 175 personnel across multiple functions within our company, including acquired entities, a \$6.8 million write-off of previously capitalized patent defense costs as a result of unsuccessful litigation and \$2.1 million of contract termination costs.

*Fiscal 2009*

In fiscal 2009, we recorded restructuring and other charges of \$5.4 million, of which \$5.3 million related to the elimination of approximately 220 personnel across multiple functions within our company.

The following table sets forth the fiscal 2011, 2010 and 2009 accrual activity relating to restructuring and other charges (dollars in thousands):

|                                      | <u>Personnel</u> | <u>Facilities</u> | <u>Other</u> | <u>Total</u>    |
|--------------------------------------|------------------|-------------------|--------------|-----------------|
| Balance at October 1, 2008           | \$ 366           | \$ 759            | \$ 1,393     | \$ 2,518        |
| Restructuring and other charges, net | 5,283            | 95                | 31           | 5,409           |
| Cash payments                        | (5,042)          | (544)             | (1,396)      | (6,982)         |
| Balance at September 30, 2009        | 607              | 310               | 28           | 945             |
| Restructuring and other charges, net | 9,634            | 155               | 8,871        | 18,660          |
| Non-cash adjustment                  | —                | —                 | (6,833)      | (6,833)         |
| Cash payments                        | (8,403)          | (182)             | (2,066)      | (10,651)        |
| Balance at September 30, 2010        | 1,838            | 283               | —            | 2,121           |
| Restructuring and other charges, net | 9,077            | 1,890             | 11,983       | 22,950          |
| Non-cash adjustment                  | 208              | —                 | (11,890)     | (11,682)        |
| Cash payments                        | (6,002)          | (1,233)           | (93)         | (7,328)         |
| Balance at September 30, 2011        | <u>\$ 5,121</u>  | <u>\$ 940</u>     | <u>\$ —</u>  | <u>\$ 6,061</u> |

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Restructuring and other charges, net by segment are as follows (dollars in thousands):

|                         | <u>Personnel</u> | <u>Facilities</u> | <u>Other</u>     | <u>Total</u>     |
|-------------------------|------------------|-------------------|------------------|------------------|
| <b>Fiscal Year 2009</b> |                  |                   |                  |                  |
| Healthcare              | \$ 1,378         | \$ —              | \$ 27            | \$ 1,405         |
| Mobile and Consumer     | 1,142            | —                 | —                | 1,142            |
| Enterprise              | 1,799            | —                 | —                | 1,799            |
| Imaging                 | 306              | —                 | —                | 306              |
| Corporate               | 658              | 95                | 4                | 757              |
| Total fiscal year 2009  | <u>\$ 5,283</u>  | <u>\$ 95</u>      | <u>\$ 31</u>     | <u>\$ 5,409</u>  |
| <b>Fiscal Year 2010</b> |                  |                   |                  |                  |
| Healthcare              | \$ 814           | \$ —              | \$ —             | \$ 814           |
| Mobile and Consumer     | 5,307            | —                 | 2,038            | 7,345            |
| Enterprise              | 1,794            | —                 | —                | 1,794            |
| Imaging                 | 215              | 155               | —                | 370              |
| Corporate               | 1,504            | —                 | 6,833            | 8,337            |
| Total fiscal year 2010  | <u>\$ 9,634</u>  | <u>\$ 155</u>     | <u>\$ 8,871</u>  | <u>\$ 18,660</u> |
| <b>Fiscal 2011</b>      |                  |                   |                  |                  |
| Healthcare              | \$ 419           | \$ —              | \$ 11,725        | \$ 12,144        |
| Mobile and Consumer     | 5,091            | —                 | —                | 5,091            |
| Enterprise              | 1,867            | 1,304             | —                | 3,171            |
| Imaging                 | 839              | —                 | —                | 839              |
| Corporate               | 861              | 586               | 258              | 1,705            |
| Total fiscal year 2011  | <u>\$ 9,077</u>  | <u>\$ 1,890</u>   | <u>\$ 11,983</u> | <u>\$ 22,950</u> |

**15. Supplemental Cash Flow Information**

*Cash paid for Interest and Income Taxes:*

|                   | <u>Year Ended September 30,</u> |             |             |
|-------------------|---------------------------------|-------------|-------------|
|                   | <u>2011</u>                     | <u>2010</u> | <u>2009</u> |
|                   | (Dollars in thousands)          |             |             |
| Interest paid     | \$ 23,034                       | \$ 27,899   | \$ 33,857   |
| Income taxes paid | \$ 15,949                       | \$ 14,215   | \$ 18,227   |

*Non Cash Investing and Financing Activities:*

During fiscal 2011, 2010 and 2009, we issued shares of our common stock in connection with several of our business and asset acquisitions, including shares initially held in escrow. Note 3 details the shares of our common stock, including per share prices thereof, issued in fiscal 2011, 2010, and 2009 to complete business acquisitions during those years. Note 6 details the same information with regard to our fiscal 2011 and 2010 intangible asset acquisitions. In addition, in connection with certain collaboration agreements we have issued shares of our common stock to our partners in satisfaction of our payment obligations under the terms of the agreements, which is discussed in Note 2.

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**16. Stockholders' Equity**

*Preferred Stock*

We are authorized to issue up to 40,000,000 shares of preferred stock, par value \$0.001 per share. We have designated 100,000 shares as Series A Preferred Stock and 15,000,000 shares as Series B Preferred Stock. In connection with the acquisition of ScanSoft from Xerox Corporation ("Xerox"), we issued 3,562,238 shares of Series B Preferred Stock to Xerox. On March 19, 2004, we announced that Warburg Pincus, a global private equity firm, had agreed to purchase all outstanding shares of our stock held by Xerox Corporation for approximately \$80 million, including the 3,562,238 shares of Series B Preferred Stock. The Series B Preferred Stock is convertible into shares of common stock on a one-for-one basis and has a liquidation preference of \$1.30 per share plus all declared but unpaid dividends. The holders of Series B Preferred Stock are entitled to non-cumulative dividends at the rate of \$0.05 per annum per share, payable when, and if, declared by the Board of Directors. To date, no dividends have been declared by the Board of Directors. Holders of Series B Preferred Stock have no voting rights, except those rights provided under Delaware law. The undesignated shares of preferred stock will have rights, preferences, privileges and restrictions, including voting rights, dividend rights, conversion rights, redemption privileges and liquidation preferences, as shall be determined by the Board of Directors upon issuance of the preferred stock. We have reserved 3,562,238 shares of our common stock for issuance upon conversion of the Series B Preferred Stock. Other than the 3,562,238 shares of Series B Preferred Stock that are issued and outstanding, there are no other shares of preferred stock issued or outstanding in fiscal 2011 or fiscal 2010.

*Common Stock and Common Stock Warrants*

*Private Placements of Securities*

We have, from time to time, entered into stock and warrant agreements with Warburg Pincus. In connection with these agreements, we granted Warburg Pincus the right to request that we use commercially reasonable efforts to register some or all of the shares of common stock issued to them under each of their purchase transactions, including shares of common stock underlying the warrants. The following table summarizes the warrant and stock activities with Warburg Pincus during the three year period ended September 30, 2011:

**Warrants Exercised**

| <u>Date</u>        | <u>Exercise Price<br/>per Share</u> | <u>Total Shares</u> | <u>Proceeds Received</u><br>(Dollars in thousands) |
|--------------------|-------------------------------------|---------------------|--|
| April 7, 2010      | \$ 4.94                             | 2,500,000           | \$ 12,350  |
| September 15, 2009 | 5.00                                | 3,177,570           | 15,888   |
| July 29, 2009      | 5.00                                | 863,236             | 4,316  |
| July 29, 2009      | 0.61                                | 525,732             | 321  |

**Common Stock Issued**

| <u>Date</u>      | <u>Price per Share</u> | <u>Total Shares</u> | <u>Proceeds Received</u><br>(Dollars in thousands) |
|------------------|------------------------|---------------------|--|
| January 29, 2009 | \$ 10.06               | 17,395,626          | \$ 175,046   |

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

| <u>Issuance Date</u> | <u>Price per Share</u> | <u>Total Shares</u> | <u>Expiration Date</u> |
|----------------------|------------------------|---------------------|------------------------|
| January 29, 2009     | \$ 11.57               | 3,862,422           | January 29, 2013       |
| May 20, 2008         | 20.00                  | 3,700,000           | May 20, 2012           |

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

We have determined that all of our common stock warrants should be classified within the stockholders' equity section of the accompanying consolidated balance sheets based on the conclusion that the above-noted warrants are indexed to our common stock and are exercisable only into our common stock.

### **17. 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):

|   | <u>2011</u>      | <u>2010</u>      | <u>2009</u>      |
|---|------------------|------------------|------------------|
| Cost of product and licensing                           | \$ 36            | \$ 28            | \$ 11            |
| Cost of professional services, subscription and hosting | 27,814           | 11,043           | 9,889            |
| Cost of maintenance and support                         | 2,186            | 756              | 743              |
| Research and development                                | 24,289           | 9,381            | 9,840            |
| Selling and marketing                                   | 43,264           | 38,152           | 27,057           |
| General and administrative                              | 49,707           | 40,779           | 23,867           |
|   | <u>\$147,296</u> | <u>\$100,139</u> | <u>\$ 71,407</u> |

Included in stock-based compensation for the year ended September 30, 2011 is \$35.1 million of expense related to awards that will be made as part of the fiscal 2011 annual bonus plan to employees which is included in accrued expenses at September 30, 2011. The annual bonus pool is determined by management and approved by the Compensation Committee of the Board of Directors based on financial performance targets approved at the beginning of the year. If these targets are achieved, the awards will be settled in shares based on the total bonus earned and the grant date fair value of the shares awarded to each employee.

#### ***Stock Options***

We have share-based award plans under which employees, officers and directors may be granted stock options to purchase our common stock, generally at fair market value. During fiscal 2009, 2010, and 2011, stock options have been primarily granted to senior management and officers of the Company. Our plans do not allow for options to be granted at below fair market value, nor can they be repriced at any time. Options granted under plans adopted by the Company become exercisable over various periods, typically two to four years and have a maximum term of ten years. We have also assumed options and option plans in connection with certain of our acquisitions. These stock options are governed by the plans and agreements that they were originally issued under, but are now exercisable for shares of our common stock.



**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The table below summarizes activity relating to stock options for the years ended September 30, 2011, 2010 and 2009:

|                                   | Number of<br>Shares | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term | Aggregate<br>Intrinsic<br>Value(1) |
|-----------------------------------|---------------------|--|---|------------------------------------|
| Outstanding at October 1, 2008    | 14,996,514          | \$ 7.47                                  |   |                                    |
| Assumed from SNAPin               | 1,258,708           | \$ 3.48                                  |   |                                    |
| Granted                           | 1,092,000           | \$ 12.07                                 |   |                                    |
| Exercised                         | (2,570,999)         | \$ 3.92                                  |   |                                    |
| Forfeited                         | (987,399)           | \$ 15.44                                 |   |                                    |
| Expired                           | (234,958)           | \$ 12.67                                 |   |                                    |
| Outstanding at September 30, 2009 | 13,553,866          | \$ 7.48                                  |   |                                    |
| Granted                           | 1,200,000           | \$ 13.81                                 |   |                                    |
| Exercised                         | (3,433,701)         | \$ 5.39                                  |   |                                    |
| Forfeited                         | (350,884)           | \$ 13.65                                 |   |                                    |
| Expired                           | (266,044)           | \$ 16.26                                 |   |                                    |
| Outstanding at September 30, 2010 | 10,703,237          | \$ 8.44                                  |   |                                    |
| Granted                           | 1,000,000           | \$ 16.44                                 |   |                                    |
| Exercised                         | (3,866,544)         | \$ 6.23                                  |   |                                    |
| Forfeited                         | (90,813)            | \$ 12.75                                 |   |                                    |
| Expired                           | (64,161)            | \$ 15.03                                 |   |                                    |
| Outstanding at September 30, 2011 | <u>7,681,719</u>    | \$ 10.48                                 | 3.5 years   | \$ 75.8 million                    |
| Exercisable at September 30, 2011 | <u>6,565,907</u>    | \$ 9.54                                  | 3.1 years   | \$ 70.9 million                    |
| Exercisable at September 30, 2010 | <u>9,137,554</u>    |  |   |                                    |
| Exercisable at September 30, 2009 | <u>10,575,346</u>   |  |   |                                    |

(1) The aggregate intrinsic value on this table was calculated based on the positive difference, if any, between the closing market value of our common stock on September 30, 2011 (\$20.34) and the exercise price of the underlying options.

As of September 30, 2011, the total unamortized fair value of stock options was \$3.9 million with a weighted average remaining recognition period of 1.0 year. A summary of weighted-average grant-date (including assumed options) fair value and intrinsic value of stock options exercised is as follows:

|  | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|--|-------------|-------------|-------------|
| Weighted-average grant-date fair value per share               | \$6.13      | \$5.90      | \$ 8.00     |
| Total intrinsic value of stock options exercised (in millions) | \$ 53.0     | \$ 36.1     | \$ 21.0     |

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

We use the Black-Scholes option pricing model to calculate the grant-date fair value of an award. The fair value of the stock options granted and unvested options assumed from acquisitions were calculated using the following weighted-average assumptions:

|                                 | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|---------------------------------|-------------|-------------|-------------|
| Dividend yield                  | 0.0%        | 0.0%        | 0.0%        |
| Expected volatility             | 46.1%       | 50.9%       | 55.1%       |
| Average risk-free interest rate | 1.2%        | 2.4%        | 2.7%        |
| Expected term (in years)        | 4.1         | 4.2         | 5.8         |

The dividend yield of zero is based on the fact that we have never paid cash dividends and have no present intention to pay cash dividends. Expected volatility is based on the historical volatility of our common stock over the period commensurate with the expected life of the options and the historical implied volatility from traded options with a term of 180 days or greater. The risk-free interest rate is derived from the average U.S. Treasury STRIPS rate during the period, which approximates the rate in effect at the time of grant, commensurate with the expected life of the instrument. We estimate the expected term of options granted based on historical exercise behavior.

***Restricted Awards***

We are authorized to issue equity incentive awards in the form of Restricted Awards, including Restricted Units and Restricted Stock, which are individually discussed below. Unvested Restricted Awards may not be sold, transferred or assigned. The fair value of the Restricted Awards is measured based upon the market price of the underlying common stock as of the date of grant, reduced by the purchase price of \$0.001 per share of the awards. The Restricted Awards generally are subject to vesting over a period of two to four years, and may have opportunities for acceleration for achievement of defined goals. We also issued certain Restricted Awards with vesting solely dependent on the achievement of specified performance targets. The fair value of the Restricted Awards is amortized to expense over the awards' applicable requisite service periods using the straight-line method. In the event that the employees' employment with the Company terminates, or in the case of awards with only performance goals, if those goals are not met, any unvested shares are forfeited and revert to the Company.

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Restricted Units are not included in issued and outstanding common stock until the shares are vested and released. The table below summarizes activity relating to Restricted Units:

|   | <u>Number of Shares<br/>Underlying<br/>Restricted Units —<br/>Contingent Awards</u> | <u>Number of Shares<br/>Underlying<br/>Restricted Units —<br/>Time-Based<br/>Awards</u> |
|---|---|---|
| Outstanding at October 1, 2008  | 2,414,524   | 6,857,524   |
| Assumed in acquisition of SNAPin  | —   | 299,446   |
| Granted   | 1,292,617   | 5,392,361   |
| Earned/released   | (291,450)   | (2,865,505)   |
| Forfeited   | (575,018)   | (928,496)   |
| Outstanding at September 30, 2009   | 2,840,673   | 8,755,330   |
| Granted   | 1,698,743   | 4,693,440   |
| Earned/released   | (950,253)   | (4,800,175)   |
| Forfeited   | (721,323)   | (853,481)   |
| Outstanding at September 30, 2010   | 2,867,840   | 7,795,114   |
| Granted   | 1,779,905   | 5,167,589   |
| Earned/released   | (1,312,136)   | (4,977,397)   |
| Forfeited   | (380,430)   | (699,188)   |
| Outstanding at September 30, 2011   | 2,955,179   | 7,286,118   |
| Weighted average remaining contractual term of outstanding Restricted Units                 | 1.1 years   | 1.3 years   |
| Aggregate intrinsic value of outstanding Restricted Units(1)                                | \$ 60.1 million   | \$ 148.3 million  |
| Restricted Units vested and expected to vest  | 2,364,056   | 6,510,953   |
| Weighted average remaining contractual term of Restricted Units vested and expected to vest | 1.1 years   | 1.2 years   |
| Aggregate intrinsic value of Restricted Units vested and expected to vest(1)                | \$ 48.1 million   | \$ 132.4 million  |

(1) The aggregate intrinsic value on this table was calculated based on the positive difference between the closing market value of our common stock on September 30, 2011 (\$20.34) and the exercise price of the underlying Restricted Units.

The purchase price for vested Restricted Units is \$0.001 per share. As of September 30, 2011, unearned stock-based compensation expense related to all unvested Restricted Units is \$124.7 million. Based on expectations of future performance vesting criteria, where applicable, the expense will be recognized over a weighted-average period of 1.7 years.

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

|  | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|--|-------------|-------------|-------------|
| Weighted-average grant-date fair value per share     | \$ 18.74    | \$ 13.15    | \$ 11.39    |
| Total intrinsic value of shares vested (in millions) | \$ 116.0    | \$ 91.3     | \$ 33.3     |

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Restricted Stock is included in the issued and outstanding common stock in these financial statements at the date of grant. There were no new grants of restricted stock in fiscal 2011, 2010 or 2009 and all shares were fully vested at September 30, 2009. The table below summarizes activity relating to Restricted Stock for fiscal 2009:

|                                   | Number of<br>Shares<br>Underlying<br>Restricted<br>Stock | Weighted<br>Average Grant<br>Date Fair<br>Value |
|-----------------------------------|--|---|
| Outstanding at October 30, 2008   | 625,070  | \$ 10.90  |
| Vested                            | (625,070)  | \$ 10.90  |
| Outstanding at September 30, 2009 | —  | \$ —  |

The purchase price for vested Restricted Stock is \$0.001 per share. The total intrinsic value of the shares which vested in fiscal 2009 was \$8.65 million.

In order to satisfy our employees' withholding tax liability as a result of the vesting of Restricted Stock, we have historically repurchased shares upon the employees' vesting. Similarly, in order to satisfy our employees' withholding tax liability as a result of the release of our employees' Restricted Units, including units released related to acquisitions, we have historically cancelled a portion of the common stock upon the release. In fiscal 2011, we withheld payroll taxes totaling \$36.7 million relating to 2.0 million shares of common stock that were repurchased or cancelled. Based on our estimate of the Restricted Awards that will vest or be released in fiscal 2012, and further assuming that one-third of these Restricted Awards would be repurchased or cancelled to satisfy the employee's withholding tax liability (such amount approximating the tax rate of our employees), we would have an obligation to pay cash relating to approximately 1.5 million shares during fiscal 2012.

**1995 Employee Stock Purchase Plan**

Our 1995 Employee Stock Purchase Plan ("the Plan"), as amended and restated on January 29, 2010, authorizes the issuance of a maximum of 10,000,000 shares of common stock in semi-annual offerings to employees at a price equal to the lower of 85% of the closing price on the applicable offering commencement date or 85% of the closing price on the applicable offering termination date. Stock-based compensation expense for the employee stock purchase plan is recognized for the fair value benefit accorded to participating employees. At September 30, 2011, 3,701,294 shares were reserved for future issuance. A summary of the weighted-average grant-date fair value, shares issued and total stock-based compensation expense recognized related to the Plan are as follows:

|  | 2011   | 2010   | 2009   |
|--|--------|--------|--------|
| Weighted-average grant-date fair value per share     | \$4.63 | \$3.80 | \$3.49 |
| Total shares issued (in millions)                    | 0.9    | 1.0    | 1.2    |
| Total stock-based compensation expense (in millions) | \$ 3.7 | \$ 3.5 | \$ 3.7 |

The fair value of the purchase rights granted under this plan was estimated on the date of grant using the Black-Scholes option-pricing model that uses the following weighted-average assumptions, which were derived in a manner similar to those discussed above relative to stock options:

|                                 | 2011  | 2010  | 2009  |
|---------------------------------|-------|-------|-------|
| Dividend yield                  | 0.0%  | 0.0%  | 0.0%  |
| Expected volatility             | 35.7% | 38.7% | 62.1% |
| Average risk-free interest rate | 0.1%  | 0.2%  | 0.3%  |
| Expected term (in years)        | 0.5   | 0.5   | 0.5   |

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**18. Commitments and Contingencies**

***Operating Leases***

We have various operating leases for office space around the world. In connection with many of our acquisitions, we assumed facility lease obligations. Among these assumed obligations are lease payments related to office locations that were vacated by certain of the acquired companies prior to the acquisition date (Note 13). Additionally, certain of our lease obligations have been included in various restructuring charges (Note 14). The following table outlines our gross future minimum payments under all non-cancelable operating leases as of September 30, 2011 (dollars in thousands):

| <u>Year Ending September 30,</u> | <u>Operating Leases</u> | <u>Leases Under Restructuring</u> | <u>Other Contractual Obligations Assumed</u> | <u>Total</u>     |
|----------------------------------|-------------------------|-----------------------------------|--|------------------|
| 2012                             | \$ 26,521               | \$ 1,313                          | \$ 12,484                                    | \$ 40,318        |
| 2013                             | 23,930                  | 241                               | 2,496  | 26,667           |
| 2014                             | 19,813                  | 52                                | 2,499  | 22,364           |
| 2015                             | 17,555                  | —                                 | 2,502  | 20,057           |
| 2016                             | 16,349                  | —                                 | 1,037  | 17,386           |
| Thereafter                       | 25,321                  | —                                 | —  | 25,321           |
| <b>Total</b>                     | <b>\$129,489</b>        | <b>\$ 1,606</b>                   | <b>\$ 21,018</b>                             | <b>\$152,113</b> |

At September 30, 2011, we have subleased certain office space that is included in the above table to third parties. Total sublease income under contractual terms is \$8.5 million and ranges from approximately \$1.5 million to \$3.2 million on an annual basis through February 2016.

Total rent expense charged to operations was approximately \$23.5 million, \$20.5 million and \$19.6 million for the years ended September 30, 2011, 2010 and 2009, respectively.

***Litigation and Other Claims***

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

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

***Guarantees and Other***

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

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

required to make under all the indemnification provisions is unlimited, we believe the estimated fair value of these provisions is minimal due to the low frequency with which these provisions have been triggered.

We indemnify our directors and officers to the fullest extent permitted by law. These agreements, among other things, indemnify directors and officers for expenses, judgments, fines, penalties and settlement amounts incurred by such persons in their capacity as a director or officer of the company, regardless of whether the individual is serving in any such capacity at the time the liability or expense is incurred. Additionally, in connection with certain acquisitions we have agreed to indemnify the former officers and members of the boards of directors of those companies, on similar terms as described above, for a period of six years from the acquisition date. In certain cases we purchase director and officer insurance policies related to these obligations, which fully cover the six year periods. To the extent that we do not purchase a director and officer insurance policy for the full period of any contractual indemnification, we would be required to pay for costs incurred, if any, as described above.

**19. Pension and Other Post-Retirement Benefits**

***Defined Contribution Plan***

We have established a retirement savings plan under Section 401(k) of the Internal Revenue Code (the “401(k) Plan”). The 401(k) Plan covers substantially all of our U.S. employees who meet minimum age and service requirements, and allows participants to defer a portion of their annual compensation on a pre-tax basis. Effective July 1, 2003, Company match of employee’s contributions was established. We match 50% of employee contributions up to 4% of eligible salary. Employees who were hired prior to April 1, 2004 were 100% vested into the plan as soon as they started to contribute to the plan. Employees hired on or after April 1, 2004, vest one-third of the contribution annually over a three-year period. Our contributions to the 401(k) Plan totaled \$3.6 million, \$3.3 million and \$3.2 million for fiscal 2011, 2010 and 2009, respectively.

***Defined Benefit Pension Plans***

In accordance with the provisions set forth in ASC 715, *Compensation — Retirement Benefits*, we recognized the funded status, which is the difference between the fair value of plan assets and the projected benefit obligations, of our postretirement benefit plans in the consolidated balance sheets with a corresponding adjustment to accumulated other comprehensive income (loss), net of tax. These amounts in accumulated other comprehensive income (loss) will be subsequently recognized as net periodic pension expense.

We assumed the assets and obligations related to certain significant defined benefit pension plans in connection with our acquisition of Dictaphone, which provide certain retirement and death benefits for former Dictaphone employees located in the United Kingdom and Canada. These two pension plans are closed to new participants.

In connection with our acquisition of SVOX in June 2011, we assumed an additional defined benefit pension plan for employees in Switzerland. At the end of September, 2011, the plan benefit obligations exceed the plan assets by approximately \$1.9 million. The plan requires periodic cash contributions, including participant contributions from active employees. Company contributions in fiscal 2012 are expected to be \$0.5 million.

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The following table shows the changes in fiscal 2011 and 2010 in the projected benefit obligation, plan assets and funded status of the defined benefit pension plans (dollars in thousands):

|  | <u>Pension Benefits</u> |                   |
|--|-------------------------|-------------------|
|  | <u>2011</u>             | <u>2010</u>       |
| <b>Change in Benefit Obligations:</b>          |                         |                   |
| Benefit obligation at beginning of period      | \$25,067                | \$ 22,850         |
| Acquisitions                                   | 11,149                  | —                 |
| Service cost                                   | 294                     | 5                 |
| Interest cost                                  | 1,343                   | 1,222             |
| Curtailement gain                              | (356)                   | —                 |
| Actuarial (gain)loss                           | (3,944)                 | 1,933             |
| Currency exchange rate changes                 | (738)                   | 48                |
| Benefits paid                                  | <u>(1,238)</u>          | <u>(991)</u>      |
| Benefit obligation at end of period            | <u>31,577</u>           | <u>25,067</u>     |
| <b>Change in Plan Assets:</b>                  |                         |                   |
| Fair value of plan assets, beginning of period | 19,750                  | 17,549            |
| Acquisitions                                   | 9,062                   | —                 |
| Actual return on plan assets                   | 14                      | 2,194             |
| Employer contributions                         | 1,206                   | 843               |
| Employee contributions                         | 128                     | —                 |
| Currency exchange rate changes                 | (669)                   | 155               |
| Benefits paid                                  | <u>(1,238)</u>          | <u>(991)</u>      |
| Fair value of plan assets, end of period       | <u>28,253</u>           | <u>19,750</u>     |
| Funded status at end of period                 | <u>\$ (3,324)</u>       | <u>\$ (5,317)</u> |

The amounts recognized in our consolidated balance sheets consisted of the following (dollars in thousands):

|                          | <u>Pension Benefits</u> |                   |
|--------------------------|-------------------------|-------------------|
|                          | <u>2011</u>             | <u>2010</u>       |
| Other assets             | \$ 107                  | \$ 506            |
| Other liabilities        | <u>(3,431)</u>          | <u>(5,823)</u>    |
| Net liability recognized | <u>\$ (3,324)</u>       | <u>\$ (5,317)</u> |

The amounts recognized in accumulated other comprehensive loss as of September 30, 2011 consisted of the following (dollars in thousands):

|   | <u>Pension Benefits</u> |
|---|-------------------------|
| Actuarial loss recognized in accumulated other comprehensive loss | \$ 2,602                |

The following represents the amounts included in accumulated other comprehensive loss on the consolidated balance sheet as of September 30, 2011 that we expect to recognize in earnings during fiscal 2012 (dollars in thousands):

|                | <u>Pension Expense</u> |
|----------------|------------------------|
| Actuarial loss | \$ 95                  |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Included in the table below are the amounts relating to our UK and Swiss pension plans, which have accumulated benefit obligations and projected benefit obligations in excess of plan assets (in thousands):

|   | Pension Benefits |          |
|---|------------------|----------|
|   | 2011             | 2010     |
| Aggregate projected benefit obligations   | \$28,525         | \$21,939 |
| Aggregate accumulated benefit obligations | 28,017           | 21,939   |
| Aggregate fair value of plan assets       | 25,094           | 16,117   |

The components of net periodic benefit cost of the pension plans were as follows (dollars in thousands):

|                                   | Pension Benefits |               |
|-----------------------------------|------------------|---------------|
|                                   | 2011             | 2010          |
| Service cost                      | \$ 294           | \$ 5          |
| Interest cost                     | 1,343            | 1,222         |
| Expected return on plan assets    | (1,212)          | (1,038)       |
| Curtailement gain                 | (356)            | —             |
| Amortization of unrecognized loss | 261              | 251           |
| Net periodic pension cost         | <u>\$ 330</u>    | <u>\$ 440</u> |

**Plan Assumptions:**

Weighted-average assumptions used in developing the net periodic benefit cost for the pension plans were as follows:

|  | Pension Benefits |        |
|--|------------------|--------|
|  | 2011             | 2010   |
| Discount rate                          | 4.8%             | 5.5%   |
| Average compensation increase          | 2.0%             | N/A(1) |
| Expected rate of return on plan assets | 5.5%             | 6.2%   |

(1) Rate of compensation increase is not applicable as there were no active members in the 2010 plans.

The weighted average discount rate used in developing the benefit obligations was 4.4% and 5.0% at September 30, 2011 and 2010, respectively.

**Asset Allocation and Investment Strategy:**

The percentages of the fair value of pension plan assets actually allocated and targeted for allocation, by asset category, at September 30, 2011 and September 30, 2010, were as follows:

| Asset Category        | Actual      |             | Target      |             |
|-----------------------|-------------|-------------|-------------|-------------|
|                       | 2011        | 2010        | 2011        | 2010        |
| Equity securities     | 41%         | 54%         | 32%         | 40%         |
| Debt securities       | 52%         | 46%         | 63%         | 60%         |
| Real estate and other | 7%          | —           | 5%          | —           |
| Total                 | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> |

The plan administrators recently updated the asset allocation targets to reflect changes in the participant population and the expected period that future benefits will become payable. The investments held by the plans will



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be rebalanced during the next fiscal year to reflect this updated target allocation. The weighted average expected long-term rate of return for the plan assets is 5.5%. The expected long-term rate of return on plan assets is determined based on a variety of considerations, including established asset allocation targets and expectations for those asset classes, historical returns of the plans' assets and other market considerations. We invest our pension assets with the objective of achieving a total rate of return, over the long term, sufficient to fund future pension obligations and to minimize future pension contribution requirements. All of the assets are invested in funds offered to institutional investors that are similar to mutual funds in that they provide diversification by holding various debt and equity securities.

The fair value of total pension plan assets by major category at September 30, 2011 is as follows:

|                       | <u>September 30, 2011</u> |
|-----------------------|---------------------------|
| Equity securities     | \$ 11,720                 |
| Debt securities       | 14,576                    |
| Real estate and other | <u>1,957</u>              |
| Total pension assets  | <u>28,253</u>             |

The assets are all invested in funds which are not quoted on any active market and are valued based on the underlying debt and equity investments and their individual prices at any given time, and thus are classified as Level 2 within the fair value hierarchy as defined in ASC 820 and described in Note 12.

**Employer Contributions:**

We expect to contribute \$1.8 million to our pension plans in fiscal 2012. Included in this contribution is a minimum funding requirement associated with our UK pension which requires an annual minimum payment of £859,900 (approximately \$1.3 million based on the exchange rate at September 30, 2011) for each year through fiscal 2014.

**Estimated Future Benefit Payments:**

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid (dollars in thousands):

| <u>Year Ending September 30,</u> | <u>Pension Benefits</u> |
|----------------------------------|-------------------------|
| 2012                             | \$ 2,544                |
| 2013                             | 1,250                   |
| 2014                             | 1,266                   |
| 2015                             | 1,257                   |
| 2016                             | 1,248                   |
| Thereafter                       | <u>6,692</u>            |
| Total                            | <u>\$ 14,257</u>        |

**NUANCE COMMUNICATIONS, INC.**  
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**20. Income Taxes**

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

|                                   | Year Ended September 30, |                   |                  |
|-----------------------------------|--------------------------|-------------------|------------------|
|                                   | 2011                     | 2010              | 2009             |
| Domestic                          | \$ 10,197                | \$ (15,543)       | \$ (1,549)       |
| Foreign                           | 19,820                   | 14,478            | 22,553           |
| Income (loss) before income taxes | <u>\$ 30,017</u>         | <u>\$ (1,065)</u> | <u>\$ 21,004</u> |

The components of the (benefit) provision for income taxes are as follows (dollars in thousands):

|                                      | Year Ended September 30, |                   |                  |
|--------------------------------------|--------------------------|-------------------|------------------|
|                                      | 2011                     | 2010              | 2009             |
| <b>Current:</b>                      |                          |                   |                  |
| Federal                              | \$ 11,846                | \$ (1,634)        | \$ 1,119         |
| State                                | 6,810                    | 2,484             | 5,439            |
| Foreign                              | 17,013                   | 13,442            | 8,115            |
|                                      | <u>35,669</u>            | <u>14,292</u>     | <u>14,673</u>    |
| <b>Deferred:</b>                     |                          |                   |                  |
| Federal                              | (37,453)                 | 7,052             | 14,952           |
| State                                | (243)                    | 942               | 12,740           |
| Foreign                              | (6,194)                  | (4,252)           | (1,974)          |
|                                      | <u>(43,890)</u>          | <u>3,742</u>      | <u>25,718</u>    |
| (Benefit) provision for income taxes | <u>\$ (8,221)</u>        | <u>\$ 18,034</u>  | <u>\$ 40,391</u> |
| Effective income tax rate            | <u>(27.4)%</u>           | <u>(1,693.3)%</u> | <u>192.3%</u>    |

The benefit (provision) for income taxes differed from the amount computed by applying the federal statutory rate to our income (loss) before income taxes as follows (dollars in thousands):

|  | 2011              | 2010             | 2009             |
|--|-------------------|------------------|------------------|
| Federal tax provision (benefit) at statutory rate    | \$ 10,506         | \$ (373)         | \$ 7,351         |
| State tax, net of federal benefit                    | 4,182             | 3,059            | 7,137            |
| State tax law enactment, net of federal benefit      | —                 | —                | 11,241           |
| Foreign tax rate and other foreign related tax items | 2,831             | (2,274)          | (1,748)          |
| Stock-based compensation                             | 6,459             | 3,185            | 4,919            |
| Non-deductible expenditures                          | 10,965            | 509              | 2,487            |
| Change in U.S. and foreign valuation allowance       | (44,792)          | 10,217           | 6,320            |
| Executive compensation                               | 3,946             | 4,063            | 2,139            |
| Other  | (2,318)           | (352)            | 545              |
| (Benefit) provision for income taxes                 | <u>\$ (8,221)</u> | <u>\$ 18,034</u> | <u>\$ 40,391</u> |

Included in fiscal 2011 benefit for income taxes is a decrease in the valuation allowance of \$34.7 million related to a one-time tax benefit recorded in connection with the Equitrac acquisition for which a net deferred tax liability was recorded in purchase accounting. This released our valuation allowance resulting in the recognition of a tax benefit during fiscal 2011. Additionally, we have released a \$10.6 million valuation allowance associated with

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

a previously acquired intangible asset which has been changed from an indefinite life asset to a finite life asset during fiscal 2011.

Included in fiscal 2010 provision for income taxes is an increase in the valuation allowance of \$7.0 million related to the unbenefited losses in the U.K. subsequent to the December 2009 acquisition of SpinVox. Additionally, tax benefits were recorded for the favorable settlements of a \$1.1 million U.S. federal tax audit contingency related to our acquisition of eCopy and a \$1.0 million state tax penalty contingency related to our acquisition of eScription. We also recorded a \$1.1 million U.S. federal tax benefit related to certain tax loss carrybacks resulting from a tax law change and a \$1.1 million tax benefit resulting from certain international research and development credits.

The cumulative amount of undistributed earnings of our foreign subsidiaries amounted to \$96.1 million at September 30, 2011. We have not provided any additional federal or state income taxes or foreign withholding taxes on the undistributed earnings, as such earnings have been indefinitely reinvested in the business. An estimate of the tax consequences from the repatriation of these earnings is not practicable at this time resulting from the complexities of the utilization of foreign tax credits and other tax assets.

Deferred tax assets (liabilities) consist of the following at September 30, 2011 and 2010 (dollars in thousands):

|   | <u>2011</u> | <u>2010</u> |
|---|-------------|-------------|
| Deferred tax assets:                        |             |             |
| Net operating loss carryforwards            | \$ 258,179  | \$ 268,882  |
| Federal and state credit carryforwards      | 10,727      | 22,768      |
| Capitalized research and development costs  | 22,910      | 23,673      |
| Accrued expenses and other reserves         | 48,882      | 55,385      |
| Deferred revenue                            | 38,294      | 25,090      |
| Deferred compensation                       | 35,968      | 18,952      |
| Other                                       | 6,365       | 6,205       |
| Total deferred tax assets                   | 421,325     | 420,955     |
| Valuation allowance for deferred tax assets | (274,807)   | (297,513)   |
| Net deferred tax assets                     | 146,518     | 123,442     |
| Deferred tax liabilities:                   |             |             |
| Depreciation                                | (11,610)    | (1,900)     |
| Convertible debt                            | (12,000)    | (12,120)    |
| Acquired intangibles                        | (189,138)   | (170,022)   |
| Net deferred tax liabilities                | \$ (66,230) | \$ (60,600) |
| Reported as:                                |             |             |
| Long-term deferred tax assets(a)            | \$ 5,999    | \$ 3,131    |
| Long-term deferred tax liability(b)         | (72,229)    | (63,731)    |
| Net deferred tax liabilities                | \$ (66,230) | \$ (60,600) |

(a) Included in other assets in the consolidated balance sheets.

(b) Included in deferred tax liability in the consolidated balance sheets.

As of September 30, 2011, our valuation allowance for U.S. net deferred tax assets totaled \$164.8 million, which consists of \$186.2 million in beginning allowance, plus an increase of \$23.4 million to the valuation allowance due to increases in deferred tax assets during fiscal 2011 and a net decrease to the valuation allowance of \$44.8 million as a result of increase in the deferred tax liabilities as the company acquired intangibles through

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

various acquisitions and the release of \$10.6 million valuation allowance associated with a previously acquired intangible asset which has been changed from an indefinite life asset to a finite life asset during fiscal 2011. As of September 30, 2011, our valuation allowance for foreign deferred tax assets totaled \$110.0 million, which consists of \$111.3 million in beginning allowance and a \$1.3 million decrease due to decreases in net deferred tax assets in fiscal 2011.

At September 30, 2011 and 2010, we had U.S. federal net operating loss carryforwards of \$499.6 million and \$579.1 million, respectively, of which \$148.0 million and \$210.0 million, respectively, relate to tax deductions from stock-based compensation which will be recorded as additional paid-in-capital when realized. At September 30, 2011 and 2010, we had state net operating loss carryforwards of \$191.6 million and \$203.5 million, respectively. The net operating loss and credit carryforwards are subject to an annual limitation due to the ownership change limitations provided by the Internal Revenue Code of 1986 and similar state tax provisions. At September 30, 2011 and 2010, we had foreign net operating loss carryforwards of \$447.0 million and \$427.0 million, respectively. These carryforwards will expire at various dates beginning in 2012 and extending through 2029, if not utilized.

At September 30, 2011 and 2010, we had federal research and development carryforwards of \$17.7 million and \$15.2 million, respectively. At September 30, 2011 and 2010, we had state research and development credit carryforwards of \$6.4 million and \$5.9 million, respectively.

**Uncertain Tax Positions**

In accordance with the provisions of ASC 740-10, *Income Taxes*, we establish reserves for tax uncertainties that reflect the use of the comprehensive model for the recognition and measurement of uncertain tax positions. Under the comprehensive model, reserves are established when we have determined that it is more likely than not that a tax position will or will not be sustained and at the greatest amount for which the result is more likely than not.

The aggregate changes in the balance of our gross unrecognized tax benefits were as follows (dollars in thousands):

|   | September 30,    |                  |
|---|------------------|------------------|
|   | 2011             | 2010             |
| Balance, beginning of year                              | \$ 12,819        | \$ 12,148        |
| Increases for tax positions taken during current period | 1,268            | 362              |
| Increases for interest and penalty charges              | 848              | 798              |
| Increases for acquisitions                              | —                | 969              |
| Decreases for tax settlements                           | —                | (1,458)          |
| Balance, at end of year                                 | <u>\$ 14,935</u> | <u>\$ 12,819</u> |

As of September 30, 2011, \$14.9 million of the unrecognized tax benefits, if recognized, 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. We recognized interest and penalties related to uncertain tax positions in our provision for income taxes and had accrued \$2.5 million of such interest and penalties as of September 30, 2011.

We are subject to U.S. federal income tax, various state and local taxes, and international income taxes in numerous jurisdictions. The federal, state and foreign tax returns are generally subject to tax examinations for the tax years ended in 2007 through 2011.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**21. Subsequent events**

***Convertible Debt Issuance and Share Repurchase***

On October 24, 2011, we sold \$690 million of 2.75% Convertible Debentures due November 1, 2031 (the “2031 Debentures”) in a private placement pursuant to Rule 144A of the Securities Act of 1933, as amended. Total proceeds, net of debt issuance costs of approximately \$14.0 million, were \$676.0 million. The 2031 Debentures bear interest at 2.75% per year, payable in cash semiannually.

ASC 470-20, *Debt with Conversion and Other Options*, requires us to allocate the proceeds to the liability component based on the fair value determined at the issuance date. We estimate that approximately \$534 million will be allocated to long-term debt, and \$156 million will be recorded as additional paid-in capital.

We used \$200 million of the proceeds received from the 2031 Debentures to repurchase 8,514,120 shares of our common stock on October 24, 2011. The additional proceeds will be used for potential acquisitions and other strategic transactions, and general corporate purposes including working capital and capital expenditures.

***Acquisition***

On October 6, 2011, we acquired Swype, Inc., a provider of software that allows users to type by sliding a finger or stylus from letter to letter, for approximately \$77.5 million in cash, plus \$25.0 million in contingent payments, due in eighteen months subject to certain conditions.

**22. Segment and Geographic Information and Significant Customers**

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

Prior to the fourth quarter of fiscal 2011, the Company operated in one reportable segment as the CODM regularly reviewed revenue data by market group, while reviewing gross margins, operating margins, and other measures of income or loss on a consolidated basis to manage the business, allocate resources and assess performance.

Effective in the fourth quarter of fiscal 2011, our CODM commenced regular reviews of the operating results including measures of profitability of each of our market groups; Healthcare, Mobile and Consumer, Enterprise and Imaging. As a result, we have changed our segment structure and identified our four customer-facing market groups as reportable segments as defined by ASC 280-50-1 based on the level of financial information now regularly reviewed by the CODM in allocating resources and assessing performance of each market group. The change in our reportable segments does not have any impact on our consolidated balance sheets, statements of operations, stockholders’ equity and comprehensive income (loss), and cash flows.

The Healthcare segment is primarily engaged in voice and language recognition for healthcare information management offered both by licensing and on-demand. The Mobile and Consumer segment is primarily engaged in sales of voice and language solutions that are embedded in a device (such as a cell phone, car or tablet computer) or installed on a personal computer. Our Enterprise segment offers voice and language solutions by licensing as well as on-demand solutions hosted by us that are designed to help companies better support, understand and communicate with their customers. The Imaging segment sells document capture and print management solutions that are embedded in copiers and multi-function printers as well as packaged software for document management.

Segment profit is an important measure used for evaluating performance and for decision-making purposes. Segment profit represents income from operations excluding stock-based compensation, amortization of intangible

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

assets, acquisition related costs, net, restructuring and other charges, net, costs associated with intellectual property collaboration agreements, other income (expense), net and certain unallocated corporate expenses. Segment profit includes an adjustment for acquisition-related revenue and cost of revenue which includes revenue from acquisitions that would have otherwise been recognized but for the purchase accounting treatment of these transactions. We believe that these adjustments allow for more complete comparisons to the financial results of the historical operations.

We do not track our assets by operating segment. Consequently, it is not practical to show assets by operating segment nor depreciation by operating segment. The following table presents segment results along with a reconciliation of segment profit to income (loss) before income taxes (dollars in thousands):

|  | Year Ended September 30, |            |            |
|--|--------------------------|------------|------------|
|  | 2011                     | 2010       | 2009       |
| <b>Segment revenues(a):</b>                                  |                          |            |            |
| Healthcare   | \$ 526,804               | \$ 449,270 | \$ 392,038 |
| Mobile and Consumer  | 393,343                  | 309,480    | 234,137    |
| Enterprise   | 296,373                  | 296,170    | 310,558    |
| Imaging  | 177,418                  | 140,750    | 73,579     |
| Total segment revenues                                       | 1,393,938                | 1,195,670  | 1,010,312  |
| Acquisition related revenue                                  | (75,197)                 | (76,722)   | (59,960)   |
| Total consolidated revenue                                   | 1,318,741                | 1,118,948  | 950,352    |
| <b>Segment profit(b):</b>                                    |                          |            |            |
| Healthcare   | 269,357                  | 227,417    | 184,843    |
| Mobile and Consumer  | 170,918                  | 120,022    | 107,983    |
| Enterprise   | 63,276                   | 82,266     | 89,570     |
| Imaging  | 69,116                   | 55,641     | 29,811     |
| Total segment profit   | 572,667                  | 485,346    | 412,207    |
| Corporate expenses and other, net                            | (100,288)                | (88,035)   | (88,219)   |
| Acquisition-related revenues and costs of revenue adjustment | (64,724)                 | (63,447)   | (58,415)   |
| Non-cash stock based compensation                            | (147,296)                | (100,139)  | (71,407)   |
| Amortization of intangible assets                            | (143,330)                | (135,577)  | (115,368)  |
| Acquisition-related costs, net                               | (21,866)                 | (30,611)   | (15,703)   |
| Restructuring and other charges, net                         | (22,862)                 | (17,891)   | (5,520)    |
| Costs associated with IP collaboration agreements            | (19,750)                 | (16,729)   | —          |
| Other income (expense), net                                  | (22,534)                 | (33,982)   | (36,571)   |
| Income (loss) before income taxes                            | \$ 30,017                | \$ (1,065) | \$ 21,004  |

- a) 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. Segment revenues also include revenue that the business would have otherwise recognized had we not acquired intellectual property and other assets from the same customer. These revenues are included to allow for more complete comparisons to the financial results of historical operations and in evaluating management performance.

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(b) Segment profit 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. The costs of acquisition related revenue adjustments are included to allow for more complete comparisons of the historical operations.

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

|               | 2011                | 2010                | 2009              |
|---------------|---------------------|---------------------|-------------------|
| United States | \$ 963,688          | \$ 802,049          | \$ 706,858        |
| International | 355,053             | 316,899             | 243,494           |
| Total         | <u>\$ 1,318,741</u> | <u>\$ 1,118,948</u> | <u>\$ 950,352</u> |

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

|               | September 30,<br>2011 | September 30,<br>2010 |
|---------------|-----------------------|-----------------------|
| United States | \$ 2,431,038          | \$ 2,479,952          |
| International | 809,328               | 448,105               |
| Total         | <u>\$ 3,240,366</u>   | <u>\$ 2,928,057</u>   |

**23. Quarterly Data (Unaudited)**

The following information has been derived from unaudited consolidated financial statements that, in the opinion of management, include all recurring adjustments necessary for a fair statement of such information (in thousands, except per share amounts):

|   | First<br>Quarter | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter | Year         |
|---|------------------|-------------------|------------------|-------------------|--------------|
| <b>2011</b>                                 |                  |                   |                  |                   |              |
| Total revenue                               | \$ 303,829       | \$ 318,962        | \$ 328,909       | \$ 367,041        | \$ 1,318,741 |
| Gross margin                                | \$ 186,907       | \$ 193,789        | \$ 207,865       | \$ 230,356        | \$ 818,917   |
| Net income (loss)                           | \$ (9)           | \$ 1,735          | \$ 41,621        | \$ (5,109)        | \$ 38,238    |
| Net income (loss) per share:                |                  |                   |                  |                   |              |
| Basic                                       | \$ (0.00)        | \$ 0.01           | \$ 0.14          | \$ (0.02)         | \$ 0.13      |
| Diluted                                     | \$ (0.00)        | \$ 0.01           | \$ 0.13          | \$ (0.02)         | \$ 0.12      |
| Weighted average common shares outstanding: |                  |                   |                  |                   |              |
| Basic                                       | 298,633          | 300,937           | 303,100          | 306,541           | 302,277      |
| Diluted                                     | 298,633          | 314,756           | 317,802          | 306,541           | 315,960      |

**NUANCE COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

|   | <u>First<br/>Quarter</u> | <u>Second<br/>Quarter</u> | <u>Third<br/>Quarter</u> | <u>Fourth<br/>Quarter</u> | <u>Year</u> |
|---|--------------------------|---------------------------|--------------------------|---------------------------|-------------|
| <b>2010</b>                                 |                          |                           |                          |                           |             |
| Total revenue                               | \$262,977                | \$ 273,005                | \$ 273,203               | \$ 309,763                | \$1,118,948 |
| Gross margin                                | \$ 169,382               | \$169,405                 | \$ 171,425               | \$199,366                 | \$ 709,578  |
| Net income (loss)                           | \$ (4,278)               | \$ (15,396)               | \$ (1,530)               | \$ 2,105                  | \$ (19,099) |
| Net income (loss) per share:                |                          |                           |                          |                           |             |
| Basic                                       | \$ (0.02)                | \$ (0.05)                 | \$ (0.01)                | \$ 0.01                   | \$ (0.07)   |
| Diluted                                     | \$ (0.02)                | \$ (0.05)                 | \$ (0.01)                | \$ 0.01                   | \$ (0.07)   |
| Weighted average common shares outstanding: |                          |                           |                          |                           |             |
| Basic                                       | 279,068                  | 284,994                   | 291,610                  | 293,971                   | 287,412     |
| Diluted                                     | 279,068                  | 284,994                   | 291,610                  | 307,382                   | 287,412     |



**Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

Not applicable.

**Item 9A. *Controls and Procedures***

***Disclosure Controls and Procedures***

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures. Our disclosure controls and procedures are designed (i) to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed and summarized and reported within the time periods specified in the SEC's rules and forms and (ii) to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2011, our disclosure controls and procedures were effective.

***Management Report on Internal Control Over Financial Reporting***

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and,
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions and that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of our internal control over financial reporting as of September 30, 2011, utilizing the criteria set forth in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on the results of this assessment, management (including our Chief Executive Officer and our Chief Financial Officer) has concluded that, as of September 30, 2011, our internal control over financial reporting was effective.

The attestation report concerning the effectiveness of our internal control over financial reporting as of September 30, 2011 issued by BDO USA, LLP, an independent registered public accounting firm, appears in Item 8 of this Annual Report on Form 10-K.

***Changes in Internal Controls Over Financial Reporting***

There have been no changes in our internal controls over financial reporting during the fourth quarter of fiscal 2011 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

**Item 9B. *Other Information***

None.

**PART III**

Certain information required by Part III is omitted from this Annual Report on Form 10-K since we intend to file our definitive Proxy Statement for our next Annual Meeting of Stockholders, pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended (the "Proxy Statement"), within 120 days of the end of the fiscal year covered by this report, and certain information to be included in the Proxy Statement is incorporated herein by reference.

**Item 10. *Directors, Executive Officers and Corporate Governance***

The information required by this item concerning our directors is incorporated by reference to the information set forth in the section titled "Election of Directors" in our Proxy Statement. Information required by this item concerning our executive officers is incorporated by reference to the information set forth in the section entitled "Executive Compensation, Management and Other Information" in our Proxy Statement. Information regarding Section 16 reporting compliance is incorporated by reference to the information set forth in the section entitled "Section 16(a) Beneficial Ownership Reporting Compliance" in our Proxy Statement.

Our Board of Directors adopted a Code of Business Conduct and Ethics for all of our directors, officers and employees on February 24, 2004. Our Code of Business Conduct and Ethics can be found at our website: [www.nuance.com](http://www.nuance.com). We will provide to any person without charge, upon request, a copy of our Code of Business Conduct and Ethics. Such a request should be made in writing and addressed to Investor Relations, Nuance Communications, Inc., 1 Wayside Road, Burlington, MA 01803.

To date, there have been no waivers under our Code of Business Conduct and Ethics. We will post any waivers, if and when granted, of our Code of Business Conduct and Ethics on our website at [www.nuance.com](http://www.nuance.com).

**Item 11. *Executive Compensation***

The information required by this item regarding executive compensation is incorporated by reference to the information set forth in the section titled "Executive Compensation, Management and Other Information" in our Proxy Statement.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholders Matters***

The information required by this item regarding security ownership of certain beneficial owners and management is incorporated by reference to the information set forth in the sections titled "Security Ownership of Certain Beneficial Owners and Management" and "Equity Compensation Plans" in our Proxy Statement.

**Item 13. *Certain Relationships and Related Transactions, and Director Independence***

It is the policy of the Board that all transactions required to be reported pursuant to Item 404 of Regulation S-K be subject to approval by the Audit Committee of the Board. In furtherance of relevant NASDAQ rules and our commitment to corporate governance, the charter of the Audit Committee provides that the Audit Committee shall review and approve any proposed related party transactions including, transactions required to be reported pursuant to Item 404 of Regulation S-K for potential conflict of interest situations. The Audit Committee reviews the material facts of all transactions that require the committee's approval and either approves or disapproves of the transaction. In determining whether to approve a transaction, the Audit Committee will take into account, among other factors it deems appropriate, whether the transaction is on terms no less favorable than terms generally available to an unaffiliated third-party under the same or similar circumstances.

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The additional information required by this item regarding certain relationships and related party transactions is incorporated by reference to the information set forth in the sections titled “Related Party Transactions” and “Director Independence” in our Proxy Statement.

**Item 14. *Principal Accountant Fees and Services***

The information required by this section is incorporated by reference from the information in the section entitled “Ratification of Appointment of Independent Auditors” in our Proxy Statement.

**PART IV**

**Item 15. *Exhibits and Financial Statement Schedules***

(a) The following documents are filed as a part of this Report:

- (1) Financial Statements — See Index to Financial Statements in Item 8 of this Report.
- (2) Financial Statement Schedules — All schedules have been omitted as the requested information is inapplicable or the information is presented in the financial statements or related notes included as part of this Report.
- (3) Exhibits — See Item 15(b) of this Report below.

(b) Exhibits.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized.

NUANCE COMMUNICATIONS, INC.

By: /s/ Paul A. Ricci

Paul A. Ricci

*Chief Executive Officer and Chairman of the Board*

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed by the following persons in the capacities and on the dates indicated.

|                         |   |
|-------------------------|---|
| Date: November 29, 2011 | <u>/s/ Paul A. Ricci</u><br>Paul A. Ricci, Chief Executive Officer and<br>Chairman of the Board<br>(Principal Executive Officer)              |
| Date: November 29, 2011 | <u>/s/ Thomas L. Beaudoin</u><br>Thomas L. Beaudoin, Executive Vice President and<br>Chief Financial Officer<br>(Principal Financial Officer) |
| Date: November 29, 2011 | <u>/s/ Daniel D. Tempesta</u><br>Daniel D. Tempesta, Chief Accounting Officer and<br>Corporate Controller<br>(Principal Accounting Officer)   |
| Date: November 29, 2011 | <u>/s/ Robert J. Frankenberg</u><br>Robert J. Frankenberg, Director   |
| Date: November 29, 2011 | <u>/s/ Patrick T. Hackett</u><br>Patrick T. Hackett, Director   |
| Date: November 29, 2011 | <u>/s/ William H. Janeway</u><br>William H. Janeway, Director   |
| Date: November 29, 2011 | <u>/s/ Mark R. Laret</u><br>Mark R. Laret, Director   |
| Date: November 29, 2011 | <u>/s/ Katharine A. Martin</u><br>Katharine A. Martin, Director   |
| Date: November 29, 2011 | <u>/s/ Mark Myers</u><br>Mark Myers, Director   |
| Date: November 29, 2011 | <u>/s/ Philip Quigley</u><br>Philip Quigley, Director   |
| Date: November 29, 2011 | <u>/s/ Robert G. Teresi</u><br>Robert G. Teresi, Director   |

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**EXHIBIT INDEX**

| Exhibit Number | Exhibit Description   | Incorporated by Reference |          |         |             | Filed Herewith |
|----------------|---|---------------------------|----------|---------|-------------|----------------|
|                |   | Form                      | File No. | Exhibit | Filing Date |                |
| 2.1            | Agreement for the acquisition of the entire issued share capital of SpinVox Limited, the substitution of Foxtrot Acquisition Limited as the issuer of a debt instrument issued by SpinVox Limited, and the release and cancellation of such debt instrument in consideration of shares in Foxtrot Acquisition Limited dated December 29, 2009 | 8-K                       | 0-27038  | 2.1     | 1/5/2010    |                |
| 2.2            | Agreement for the acquisition of shares in Foxtrot Acquisition Limited and the payment of certain sums to the Mezzanine Lenders and other parties dated December 29, 2009   | 8-K                       | 0-27038  | 2.2     | 1/5/2010    |                |
| 2.3            | Share Purchase Agreement, dated as of June 6, 2011, by and among Nuance, Ruetli Holding Corporation, the shareholders of SVOX and smac partners GmbH, as the shareholder representative.  | 10-Q                      | 0-27038  | 2.1     | 8/9/2011    |                |
| 2.4            | Agreement and Plan of Merger, dated as of May 10, 2011, by and among Nuance, Ellipse Acquisition Corporation, Equitrac Corporation, U.S. Bank National Association, as escrow agent, and Cornerstone Equity Investors, LLC, as the stockholder representative.  | 10-Q                      | 0-27038  | 2.2     | 8/9/2011    |                |
| 2.5            | Agreement and Plan of Merger by and among Nuance Communications, Inc., SpeakEasy Acquisition Corporation, SpeakEasy Acquisition LLC, SNAPin Software, Inc., Thomas S. Huseby as Stockholder Representative and U.S. Bank National Association, as Escrow Agent, dated as of August 13, 2008.  | 8-K                       | 0-27038  | 2.1     | 10/3/2008   |                |
| 2.6            | Amendment effective as of September 24, 2008, by and among Nuance Communications, Inc., SpeakEasy Acquisition Corporation, SpeakEasy Acquisition LLC, SNAPin Software, Inc., Thomas S. Huseby as Stockholder Representative and U.S. Bank National Association, as Escrow Agent.  | 8-K                       | 0-27038  | 2.2     | 10/3/2008   |                |
| 2.7            | Share Purchase Agreement dated August 12, 2011 by and between Nuance Communications, Inc. and Telecom Italia  |                           |          |         |             | X              |
| 2.8            | Agreement and Plan of Merger dated as of October 6, 2011, by and among Nuance Communications, Inc., Sonic Acquisition Corporation, Swype, Inc., and Adrian Smith, as shareholder representative.  | 8-K                       | 0-27038  | 2.1     | 10/7/2011   |                |
| 3.1            | Amended and Restated Certificate of Incorporation of the Registrant.  | 10-Q                      | 0-27038  | 3.2     | 5/11/2001   |                |

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| Exhibit Number | Exhibit Description  | Incorporated by Reference |            |         |             | Filed Herewith |
|----------------|--|---------------------------|------------|---------|-------------|----------------|
|                |  | Form                      | File No.   | Exhibit | Filing Date |                |
| 3.2            | Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Registrant.   | 10-Q                      | 0-27038    | 3.1     | 8/9/2004    |                |
| 3.3            | Certificate of Ownership and Merger.   | 8-K                       | 0-27038    | 3.1     | 10/19/2005  |                |
| 3.4            | Amended and Restated Bylaws of the Registrant.   | 8-K                       | 0-27038    | 3.1     | 11/13/2007  |                |
| 3.5            | Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Registrant, as amended.   | S-3                       | 333-142182 | 3.3     | 4/18/2007   |                |
| 4.1            | Specimen Common Stock Certificate.   | 8-A                       | 0-27038    | 4.1     | 12/6/1995   |                |
| 4.3            | Common Stock Purchase Warrants, dated March 15, 2004, issued to Warburg Pincus Private Equity VIII, L.P., Warburg Pincus Netherlands Private Equity VIII I C.V., Warburg Pincus Netherlands Private Equity VIII II C.V., and Warburg Pincus Germany Private Equity VIII K.G.   | 10-Q                      | 0-27038    | 4.3     | 5/10/2004   |                |
| 4.4            | Common Stock Purchase Warrants, dated May 9, 2005, issued to Warburg Pincus Private Equity VIII, L.P., Warburg Pincus Netherlands Private Equity VIII I C.V., and Warburg Pincus Germany Private Equity VIII K.G.  | S-4                       | 333-125496 | 4.11    | 6/3/2005    |                |
| 4.5            | Indenture, dated as of August 13, 2007, between Nuance Communications, Inc. and U.S. Bank National Association, as Trustee (including form of 2.75% Convertible Subordinated Debentures due 2027).   | 8-K                       | 0-27038    | 4.1     | 8/17/2007   |                |
| 4.6            | Purchase Agreement, dated as of April 7, 2008 by and among Nuance Communications, Inc. and the Purchasers identified on Exhibit A (Warburg Pincus Private Equity VIII, L.P., Warburg Pincus Netherlands Private Equity VIII, C.V.I., WP-WP VIII Investors, L.P.).  | 8-K                       | 0-27038    | 2.2     | 4/11/2008   |                |
| 4.7            | Purchase Agreement, dated as of January 13, 2009, by and among Nuance Communications, Inc. and the Purchasers identified on Exhibit A (Warburg Pincus Private Equity X, L.P. and Warburg Pincus X Partners, L.P.).   | 8-K                       | 0-27038    | 2.1     | 1/16/2009   |                |
| 4.8            | Third Amended and Restated Stockholders Agreement, dated as of January 29, 2009, by and among Nuance Communications, Inc., Warburg Pincus Private Equity VIII, L.P., Warburg Pincus Netherlands Private Equity VIII C.V. I, and WP-WPVIII Investors, L.P., Warburg Pincus Private Equity X, L.P. and Warburg Pincus X Partners, L.P. | 10-Q                      | 0-27038    | 4.1     | 2/9/2009    |                |

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| Exhibit Number | Exhibit Description   | Incorporated by Reference |            |         |             | Filed Herewith |
|----------------|---|---------------------------|------------|---------|-------------|----------------|
|                |   | Form                      | File No.   | Exhibit | Filing Date |                |
| 4.9            | Indenture, dated as of October 24, 2011, by and between Nuance Communications, Inc. and U.S. Bank National Association                    | 8-K                       | 0-27038    | 4.1     | 10/24/2011  |                |
| 10.1           | Form of Indemnification Agreement.  | S-8                       | 333-108767 | 10.1    | 9/12/2003   |                |
| 10.2           | Stand Alone Stock Option Agreement Number 1, dated as of August 21, 2000, by and between the Registrant and Paul A. Ricci.*               | S-8                       | 333-49656  | 4.3     | 11/9/2000   |                |
| 10.3           | Caere Corporation 1992 Non-Employee Directors' Stock Option Plan.*  | S-8                       | 333-33464  | 10.4    | 3/29/2000   |                |
| 10.4           | 1993 Incentive Stock Option Plan, as amended.*  | S-1                       | 333-100647 | 10.17   | 10/21/2002  |                |
| 10.5           | 1995 Employee Stock Purchase Plan, as amended and restated on April 27, 2000.*  | 14A                       | 0-27038    | Annex D | 4/13/2004   |                |
| 10.6           | Amended and Restated 1995 Directors' Stock Option Plan, as amended.*  | 14A                       | 0-27038    | 10.2    | 3/17/2005   |                |
| 10.7           | 1997 Employee Stock Option Plan, as amended.*   | S-1                       | 333-100647 | 10.19   | 10/21/2002  |                |
| 10.8           | 1998 Stock Option Plan.*  | S-8                       | 333-74343  | 99.1    | 3/12/1999   |                |
| 10.9           | Amended and Restated 2000 Stock Option Plan.*   | 14A                       | 0-27038    | 10.1    | 3/17/2005   |                |
| 10.10          | 2000 NonStatutory Stock Option Plan, as amended.*   | S-8                       | 333-108767 | 4.1     | 9/12/2003   |                |
| 10.11          | ScanSoft 2003 Stock Plan.*  | S-8                       | 333-108767 | 4.3     | 9/12/2003   |                |
| 10.12          | Nuance Communications, Inc. 2001 Nonstatutory Stock Option Plan.*   | S-8                       | 333-128396 | 4.1     | 9/16/2005   |                |
| 10.13          | Nuance Communications, Inc. 2000 Stock Plan.*   | S-8                       | 333-128396 | 4.2     | 9/16/2005   |                |
| 10.14          | Nuance Communications, Inc. 1998 Stock Plan.*   | S-8                       | 333-128396 | 4.3     | 9/16/2005   |                |
| 10.15          | Nuance Communications, Inc. 1994 Flexible Stock Incentive Plan.*  | S-8                       | 333-128396 | 4.4     | 9/16/2005   |                |
| 10.16          | Form of Restricted Stock Purchase Agreement.*   | 10-K/A                    | 0-27038    | 10.17   | 12/15/2006  |                |
| 10.17          | Form of Restricted Stock Unit Purchase Agreement.*  | 10-K/A                    | 0-27038    | 10.18   | 12/15/2006  |                |
| 10.18          | Form of Stock Option Agreement.*  | 10-K/A                    | 0-27038    | 10.19   | 12/15/2006  |                |
| 10.19          | 2005 Severance Benefit Plan for Executive Officers.*  | 10-Q                      | 0-27038    | 10.1    | 5/10/2005   |                |
| 10.20          | Officer Short-term Disability Plan.*  | 10-Q                      | 0-27038    | 10.2    | 5/10/2005   |                |
| 10.21          | Technology Transfer and License Agreement, dated as of January 30, 2003, between Koninklijke Philips Electronics N.V. and the Registrant. | S-1/A                     | 333-100647 | 10.30   | 2/7/2003    |                |

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| Exhibit<br>Number | Exhibit Description   | Incorporated by Reference |          |         |                | Filed<br>Herewith |
|-------------------|---|---------------------------|----------|---------|----------------|-------------------|
|                   |   | Form                      | File No. | Exhibit | Filing<br>Date |                   |
| 10.24             | Letter, dated May 23, 2004, from the Registrant to Steven Chambers regarding certain employment matters.*   | 10-Q                      | 0-27038  | 10.2    | 8/9/2004       |                   |
| 10.25             | Increase Joinder, dated as of August 24, 2007, by and among Nuance Communications, Inc. and the other parties identified therein, to the Amended and Restated Senior Secured Credit Facility dated as of April 5, 2007. | 8-K                       | 0-27038  | 10.1    | 8/30/2007      |                   |
| 10.26             | Amended and Restated 2000 Stock Plan.   | 8-K                       | 0-27038  | 10.1    | 1/12/2011      |                   |
| 10.27             | Letter, dated June 3, 2008, from the Registrant to Thomas L. Beaudoin regarding certain employment matters.   | 10-K                      | 0-27038  | 10.39   | 12/1/2008      |                   |
| 10.28             | Amended and Restated Employment Agreement, dated as of December 29, 2008, by and between Nuance Communications, Inc. and Paul Ricci.*   | 10-Q                      | 0-27038  | 10.1    | 2/9/2009       |                   |
| 10.29             | Amended and Restated Stock Plan.*   | 8-K                       | 0-27038  | 99.1    | 2/5/2009       |                   |
| 10.30             | Amended and Restated Employment Agreement, dated as of June 23, 2009, by and between Nuance Communications, Inc. and Paul Ricci.*   | 8-K                       | 0-27038  | 99.1    | 6/26/2009      |                   |
| 10.31             | Letter, dated March 29, 2010, to Janet Dillione regarding certain employment matters.   | 10-Q                      | 0-27038  | 10.1    | 8/9/2010       |                   |
| 10.32             | Letter, dated September 9, 2010, to Bruce Bowden regarding certain employment matters.*   | 10-Q                      | 0-27038  | 10.1    | 2/9/2011       |                   |
| 10.33             | Amended and Restated 2000 Stock Plan, as amended.*  | 10-Q                      | 0-27038  | 10.2    | 2/9/2011       |                   |

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| Exhibit Number | Exhibit Description  | Incorporated by Reference |          |         |             | Filed Herewith |
|----------------|--|---------------------------|----------|---------|-------------|----------------|
|                |  | Form                      | File No. | Exhibit | Filing Date |                |
| 10.34          | Amendment Agreement, dated as of July 7, 2011, among Nuance Communications, the Lenders party thereto, UBS AG, Stamford Branch, as administrative agent and as collateral agent, Citigroup Global Markets Inc. as sole lead arranger and sole book runner and the other parties thereto from time to time to the Credit Agreement.   | 10-Q                      | 0-27038  | 10.1    | 7/7/2011    |                |
| 10.35          | Amended and Restated Credit Agreement, dated as of July 7, 2011 among Nuance, UBS AG, Stamford Branch, as administrative agent, Citicorp North America, Inc., as syndication agent, Credit Suisse Securities (USA) LLC, as documentation agent, Citigroup Global Markets Inc. and UBS Securities LLC, as joint lead arrangers, Credit Suisse Securities (USA) LLC and Banc Of America Securities LLC as co-arrangers, and Citigroup Global Markets Inc., UBS Securities LLC and Credit Suisse Securities (USA) LLC as joint bookrunners. | 10-Q                      | 02-7308  | 10.2    | 7/7/2011    |                |
| 10.36          | Letter dated March 14, 2011 to Bill Nelson regarding certain employment matters.*  | 10-Q                      | 02-7308  | 10.1    | 8/9/2011    |                |
| 14.1           | Registrant's Code of Business Conduct and Ethics.  | 10-K                      | 0-27038  | 14.1    | 3/15/2004   |                |
| 21.1           | Subsidiaries of the Registrant.  |                           |          |         |             | X              |
| 23.1           | Consent of BDO USA, LLP.   |                           |          |         |             | X              |
| 24.1           | Power of Attorney. (See Signature Page).   |                           |          |         |             | X              |
| 31.1           | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a).  |                           |          |         |             | X              |
| 31.2           | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a).  |                           |          |         |             | X              |
| 32.1           | Certification Pursuant to 18 U.S.C. Section 1350.  |                           |          |         |             | X              |
| 101            | The following materials from Nuance Communications, Inc.'s Annual Report on Form 10-K for the fiscal year ended September 30, 2011, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Operations, (ii) the Consolidated Balance Sheets, (iii) the Consolidated Statements of Stockholders' Equity and Comprehensive Loss, (iv) the Consolidated Statements of Cash Flows, and (v) Notes to Consolidated Financial Statements.   |                           |          |         |             | X              |

\* Denotes management compensatory plan or arrangement

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**SHARE PURCHASE AGREEMENT**

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Between  
**Telecom italia S.p.A.**  
and  
**nuance communications, inc.**

**SHARE PURCHASE AGREEMENT**

This SHARE PURCHASE AGREEMENT (the “**Agreement**”) dated as of August 12, 2011 is entered into by and between

**Telecom Italia S.p.A.**, a company organized and existing under the laws of Italy, having its registered office at Piazza Affari 2, Milan, Italy, registered at no. 00488410010 of the Company Register of Milan, Italy, duly represented by Guglielmo Noya, acting pursuant to a power of attorney, a copy of which is attached hereto as Schedule 0.01 (“**TI**” or the “**Seller**”),

on one side

and

**Nuance Communications Inc.**, a company organized and existing under the laws of the State of Delaware, with registered office at One Wayside Road, Burlington, MA 01803 duly represented by Helgi Bloom, acting pursuant to a power of attorney, a copy of which is attached hereto as Schedule 0.02 (“**Buyer**”)

on other side

(both Seller and Buyer, the “**Parties**”)

**RECITALS**

- A. Loquendo S.p.A. is a company organized and existing under the laws of Italy, having its registered office at Via Arrigo Olivetti, 6 Torino Italy, registered at no. 08137760016 of the Company Register of Torino, with a share capital of Euro 3.573.741 divided into 3.573.741 common shares (“**Loquendo**” or the “**Company**”);
- B. TI owns 3,573,190 (three millions five hundred seventy three thousand one hundred ninety) common shares, of Loquendo, representing 99,98% of the share capital of the same (the “**TI Shares**”).
- C. The other shareholders of the Company are two individuals (the “**Other Shareholders**”) owning, respectively, 372 (three hundred seventy two) ordinary shares and 179 (one hundred seventy nine) ordinary shares, such shares representing 0.02% of the share capital of the same (the “**Other Shares**”).
- D. Buyer has carried out a due diligence on Loquendo, including interviews with the management and review of the documents (made available either through the

Virtual Data Room organized and managed by TI and through a physical data room relating, specifically to Loquendo's commercial contracts carried out through an independent law firm). All documents reviewed by the Buyer are contained in a DVD attached hereto as Schedule D or listed under Schedule 7.13(a).

E. The by-laws of the Company grants to the Other Shareholders the Tag-Along Right.

F. TI intends to sell the TI Shares and Buyer intends to buy the TI Shares subject to the terms and conditions contained herein after. Buyer intends to acquire also the Other Shares, in the event the Other Shareholders exercise the Tag-Along Right.

## 1. **Definitions**

### 1.1 **Certain Definitions.**

In addition to the other terms defined elsewhere in this Agreement, the following words and terms shall have the meaning set forth below:

- **“Adjustment Amount”** or **“AA”** has the meaning set forth in Section 3.3(b) of this Agreement.
- **“Adjustment Report”** has the meaning set forth in Section 3.4(d) of this Agreement.
- **“Affiliate”** means, with respect to any Party, any person which is controlled by such Party. Control means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting equity interests, by contract.
- **“Agreement”** means this share purchase agreement, together with its Recitals and Schedules.
- **“Assets”** has the meaning ascribed to it in Section 7.8 of this Agreement.
- **“Auditor”** means Ernst & Young Italia or, should it refuse its appointment for any reasons, the auditor agreed upon by the Parties or if the Parties do not reach an agreement on such auditor within 5 (five) Business Days after the refusal by Ernst & Young Italia, the auditor appointed by the President of the Chartered Accountant of Milan, which will appoint the Senior Partner of a major and recognized international accounting firm independent from the Parties involved in the Agreement and having experience in the accounting principles upon demand of any Party.
- **“Business”** has the meaning provided in Section 11.1 of this Agreement.

- “**Business Day**” any calendar day other than Saturdays, Sundays and any other days on which credit institutions are closed in the cities of Milan and Turin (Italy) and New York (New York).
- “**Cap**” has the meaning provided in Section 9.3.4(b) of this Agreement.
- “**Closing**” means the transfer of the TI Shares to the Buyer, the payment of the Estimated Purchase Price to TI and, in general, the execution and exchange of all documents and the performance of all the obligations respectively required to be executed, exchanged and performed on the Closing Date in accordance with Section 5 of this Agreement.
- “**Closing Date**” the date on which the Closing shall take place in accordance with Section 5.1 of this Agreement.
- “**Closing Statement**” has the meaning provided in Section 3.3 of this Agreement.
- “**Dispute Notice**” has the meaning provided in Section 3.4(b) of this Agreement.
- “**Disputed Item(s)**” has the meaning provided in Section 3.4(b) of this Agreement.
- “**Employees**” has the meaning provided in Section 7.11(a) of this Agreement.
- “**Encumbrance**” means any pledge, mortgage, lien or any restriction whatsoever (either in law or in contract) for the benefit of third parties.
- “**Estimated Purchase Price**” or “**EPP**” has the meaning provided in Section 3.1 of this Agreement.
- “**Estimated Net Financial Position**” or “**ENFP**” has the meaning provided in Section 3.1 of this Agreement.
- “**Euro**” or “**€**” means the single currency of the member states of the European Union which participate in the Economic and Monetary Union as contemplated by the Treaty of Rome of 25th March, 1957 establishing the European Community, as amended by the Maastricht Treaty on the European Union (signed on 7th February, 1992), as amended from time to time.
- “**Final Purchase Price**” or “**FPP**” has the meaning provided in Section 3.3(a) of this Agreement.
- “**Guarantees**” has the meaning provided in Section 4.4(c) of this Agreement.
- “**IFRS Accounting Principles**” means the policies, procedures and practices based on IFRS, according to which the ENFP and CNFP shall be calculated, as better detailed in Schedule 3.1 of this Agreement.
- “**Intellectual Property**” means patents, patent applications, utility models, inventions, trademarks (whether registered or unregistered), trademark applications, service marks, service names, trade names, copyrights, trade secrets,

domain names and Technology owned or licensed to the Company, as the case may require.

- “**Intercompany Agreements**” has the meaning provided in Section 4.4(e) of this Agreement.
- “**Interim Period**” means the period falling between the date of execution of this Agreement and the Closing Date;
- “**Italian Accounting Principles and Practices**” the accounting principles prepared by the Consiglio Nazionale dei Dottori Commercialisti e dei Ragionieri, as amended and/or specified by the Organismo Italiano di Contabilità (O.I.C.), applied consistently and in accordance with the past practice and methodologies of the Company, according to which the Company has prepared the Reference Financial Statements.
- “**Loquendo**” or the “**Company**” has the meaning provided in preamble A of this Agreement.
- “**Loss**” has the meaning provided in Section 9.1.2 of this Agreement.
- “**Material Contracts**” has the meaning provided in Section 7.13(a) of this Agreement.
- “**Net Financial Position at Closing**” or “**CNFP**” has the meaning provided in Section 3.3(a) of this Agreement.
- “**Ordinary Course of Business**” means a lawful action taken by a person that is consistent with the past practice of such person and is taken in the ordinary course of the normal day to day operations of such Company after due consideration and in accordance with professional standards.
- “**Other Shareholders**” has the meaning provided in preamble C of this Agreement.
- “**Other Shares**” has the meaning provided in preamble C of this Agreement.
- “**Reference Financial Statements**” means the financial statements of the Company as at December 31, 2010, duly audited by the auditor of the Company, a copy of which (together with the auditor report on such Reference Financial Statements) is attached hereto as Schedule F.
- “**Social Security Charges**” means employment or other social security charges (including any payroll-related charges and related contributions).
- “**Tag-Along Right**” means the right established by article 6 of the by-laws of the Company according to which in the event the majority shareholder of the Company intends to sell its shares in the Company to third parties (“Purchaser”) each of the minority shareholders is granted the right to sell the shares they own in Loquendo to the Purchaser and upon the same economic terms of the sale of

the shares owned by the majority shareholder. Article 6 of the Company's by-laws is attached hereto as Schedule E.

- **“Tax”** means all taxes and duties imposed by any national or local taxing authority having jurisdiction on the relevant company, including (without limitation) income, employment, property, excise, sale, use, VAT and franchise taxes.
- **“Technology”** means any or all of the following (i) works of authorship including, without limitation, computer programs, source code, and executable code, whether embodied in software, firmware or otherwise, architecture, documentation, designs, files, records, databases, and data, (ii) inventions (whether or not patentable), discoveries, improvements, and technology, (iii) proprietary and confidential information, trade secrets and know how, (iv) databases, data compilations and collections and technical data, (v) domain names, web addresses and sites, (vi) tools, methods and processes, and (vii) any and all instantiations or embodiments of the foregoing in any form and embodied in any media.
- **“Threshold”** has the meaning provided in Section 9.3.4(a)(ii) of this Agreement.
- **“TI Company”** and, collectively, **“TI Companies”** means the Seller and any person controlled by the Seller, other than the Company.
- **“TI Shares”** has the meaning provided in preamble B of this Agreement.
- **“US GAAP”** shall mean United States generally accepted accounting principles consistently applied.

## 1.2 Other Definitional and Interpretative Matters

Unless otherwise expressly provided, the following rules shall apply.

Gender and Number: any reference in this Agreement to gender shall include all genders, and words importing the singular number only shall include the plural and vice versa.

Headings: the provision of a table of contents, the division of this Agreement into Sections and other subdivisions and the insertion of headings are for convenience of reference only and shall not affect or be utilized in construing or interpreting this Agreement.

Section: any reference to Sections, Subsections, Paragraphs or Schedules contained in this Agreement shall be deemed to be a reference to Sections, Subsections, Paragraphs hereof or Schedules hereto.

Hereof: the words “hereof”, “herein” and “hereunder” and similar words, when used in this Agreement, shall refer to this Agreement as a whole and not to any particular provision thereof.

Including: the word “including” or any variation thereof means “including, without limitation” and shall not be construed as to limit any general statement to the specific or similar items or matters immediately following it.

Schedules: the Schedules attached to this Agreement shall be construed with and as an integral part of this Agreement to the same extent as if the same had been set forth verbatim herein.

Knowledge of the Seller: where any representation or warranty contained in this Agreement is expressly qualified by reference to the knowledge or the best knowledge of the Seller, this shall mean the actual knowledge by the Seller of the circumstances described in that certain representation or warranty, and that which a reasonable and prudent director or the CFO (Mr. Francesco Melchiorre) of the Company would have obtained by exercising its duties and by conducting all reasonable inquiries.

## 2. Sale and Purchase of the Shares

- (i) Subject to the terms and conditions of this Agreement, at the Closing TI shall sell to the Buyer, and the Buyer shall purchase the TI Shares, together with all rights attached thereto.
- (ii) Title to the TI Shares will be transferred to the Buyer, free of any Encumbrances, on the Closing Date upon full payment of the Estimated Purchase Price and fulfillment of all closing activities as set forth under Section 5.2.

## 3. Purchase Price and price adjustment

### 3.1. Purchase Price

As consideration for the purchase and sale of the TI Shares (and subject to the price adjustment according to Section 3.3), at the Closing Date the Buyer shall pay the estimated purchase price (the “**Estimated Purchase Price**” or “**EPP**”) which the Parties have agreed to be equal to be the result from the following algebraic sum made by the Seller:

$$\text{ESTIMATED PURCHASE PRICE} = \text{EV} + \text{ENFP}$$

where:

- EV is the enterprise value of the Company equal to Euro 53,000,000.00 (fifty three million); this amount has been unconditionally and finally agreed between the Buyer and the Seller (the “**Enterprise Value**” or “**EV**”); and
- ENFP is the estimated net financial position of the Company at the Closing Date which shall be calculated by the Seller in good faith and in accordance to the criteria set forth in Schedule 3.1 and to the IFRS Accounting Principles, together with the relevant underlying calculations and figures and communicated by the



Seller to the Buyer at least 7 (seven) Business Days before the Closing Date (the “**Estimated Net Financial Position**” or “**ENFP**”), such ENFP not to exceed the amount of Euros 4 million.

### 3.2. *Payment of the Estimated Purchase Price*

The Estimated Purchase Price shall be paid on the Closing Date by the Buyer to the Seller in Euro and in immediately available funds by wire transfer to the bank account notified by the Seller to the Buyer at least 5 (five) Business Days prior to the Closing Date.

### 3.3. *Price adjustment mechanism and payment of the Adjustment Amount.*

Within 30 (thirty) Business Days after the Closing Date, the Buyer shall deliver to the Seller a statement (the “**Closing Statement**”), setting forth in detail the Buyer’s calculation, carried out in accordance with the Italian Accounting Principles and Practices, of each of the following items:

- (a) the final purchase price (the “**Final Purchase Price**” or “**FPP**”), it being the result of the following algebraic sum:

$$\text{FINAL PURCHASE PRICE} = \text{EV} + \text{CNFP}$$

where:

- EV is the Enterprise Value; and

- CNFP is the net financial position of the Company at the Closing Date, calculated in accordance with the criteria, principles and definitions set forth in Exhibit 3.3 and with the IFRS Accounting Principles (the “**Net Financial Position at Closing**” or “**CNFP**”); and

- (b) the amount of the adjustment (the “**Adjustment Amount**” or “**AA**”), it being the result of the following algebraic sum:

$$\text{AA} = \text{FPP} - \text{EPP}$$

Together with the above mentioned statement, the Buyer shall provide the Seller with all the relevant documentation on which it has based its calculation.

### 3.4. *Procedure*

- (a) The Seller will have 20 (twenty) Business Days from the date it receives the Closing Statement to review the documents provided. The Buyer shall — and shall cause the

Company to - cooperate with the Seller in order to provide it with all the information, data and documents the Seller may reasonably deem necessary to make its assessment.

- (b) If the Seller disagrees in any respect with any item, including the amount it reasonably believes to be the correct amount for such disputed item (the “**Disputed Item(s)**”) shown or reflected in the Closing Statement, it may, within such 20 (twenty)-Business-Day period deliver a written notice to the Buyer setting forth, in reasonable detail, each Disputed Item, the basis for its disagreement therewith together with, if applicable, its supporting calculations and the respective results, including its proposal of Adjustment Amount (the “**Dispute Notice**”). The dispute shall be resolved in accordance with the procedure set out in Section 3.4(c) and 3.4(d) here below.

In any event, it is hereby agreed between the Parties that the Final Purchase Price and the Adjustment Amount will become final and binding on the Parties, if:

- (i) no Dispute Notice is received by the Buyer on or prior to the end of such 20-Business-Day period, or
  - (ii) the Seller has notified the Buyer in writing that the Seller accepts the Closing Statement and the amounts resulting there from, or
  - (iii) the Closing Statement has been adjusted to reflect the Disputed Item(s) having been amicably resolved between the Seller and the Buyer in writing or
  - (iv) the Adjustment Amount has been determined by the Auditor in accordance with the procedure as set out below in Section 3.4.(c) below.
- (c) Conversely, if a Dispute Notice has been received by the Buyer, then the Parties shall discuss whether an amicable written agreement can be reached. If within 20 (twenty) Business Days after receipt of the Dispute Notice (or such longer period as may be agreed in writing by the Parties), the Disputed Item(s) indicated in the Dispute Notice have, for any reason, not been resolved by mutual written agreement of the Parties, each of the Buyer or the Seller may request that the Auditor resolves the Disputed Items set forth in the Dispute Notice. The Auditor shall:
- (i) conduct a review of the Closing Statement (and the amounts resulting there from), the Dispute Notice, and any supporting documentation as the auditor in its sole discretion will deem necessary but limited to resolving the Disputed Items reflected in the Dispute Notice;
  - (ii) be required to justify its determination;
  - (iii) be empowered to act in compliance with article 1473, first paragraph, and 1349, first paragraph, of the Italian Civil Code, and shall settle as arbitrator any

disputes which may be necessary to be settled for the calculation of the Adjustment Amount.

- (d) The Auditor shall, as promptly as practicable and in no event later than 20 (twenty) Business Days following its appointment by the Buyer and/or the Seller, deliver to the Buyer and the Seller a report (the “**Adjustment Report**”), in which the Auditor will resolve only the Disputed Items set forth in the Dispute Notice and will determine, with supporting calculations, the appropriate values of CNFP, FPP, and AA on that basis.

The Seller and the Buyer shall each promptly provide (and to the extent they are reasonably able shall procure that their respective accountants and the Company promptly provide) the Auditor with all information which it reasonably requires and the Auditor shall be entitled (to the extent it considers it appropriate) to base its opinion on such information and on the accounting and other records of the Company.

The Adjustment Report will be final and binding on the Parties. In resolving any Disputed Item, the Auditor may not assign a value to such Disputed Item that it is outside the range of values for such Disputed Item claimed by any of the Parties. The Auditor’s fees shall be allocated on a 50/50 basis between Seller and Buyer.

- (e) The Adjustment Amount will be paid within the 5th (fifth) Business Day after the Adjustment Amount has been finally determined by wire transfer of immediately available funds, in Euro and free of all charges and unconditionally, as the case may be, either to the Seller’s bank account or to the Buyer’s bank account, the details of which accounts will be notified by the respective Party to the other Party at the latest the second (2<sup>nd</sup>) Business Day Adjustment Amount has been finally determined. In particular, it is hereby agreed that if the Adjustment Amount is positive it shall be paid from the Buyer to the Seller and if the Adjustment Amount is negative it shall be paid from the Seller to the Buyer.

### *3.5 Financials*

Notwithstanding any provision to the contrary herein, the Parties expressly agree that in no event shall the Financials, as defined in clause 4.1 hereafter, have any impact of any nature whatsoever on the Final Purchase Price or any components thereof.

## **4. Condition precedent and actions prior to the Closing Date**

### *4.1 Conditions precedent*

Buyer shall have received (i) the Company’s audited balance sheets as of December 31, 2010 and 2009, and the statements of income, cash flow and

stockholders' equity for the twelve (12) month periods ended December 31, 2010 and 2009 (the “**Year-End Financials**”), which shall include all required footnote disclosures and Company's unaudited balance sheets as of June 30, 2011, and the related unaudited statement of income, cash flow and stockholders' equity for the six month periods ended June 30, 2011 and 2010, including all required interim footnote disclosures, (the “**Interim Financials**” and, together with the Year End Financials, the “**Financials**”) reviewed by the Company's independent auditors in accordance with Statement of Auditing Standards No. 100, in each case prepared in accordance with U.S. GAAP applied on a consistent basis throughout the periods indicated and (ii) a letter from the Company's independent accountants, substantially in the form set forth in Schedule 4.1 to the effect that they do not envisage any reason why they could not deliver (a) consent to allow the inclusion or incorporation by reference of their audit report on the Year-End Financials into a registration statement to be filed with the SEC or (b) a comfort letter in accordance with the guidance set out in Statement on Auditing Standards no. 72 (SAS 72) “Letters for Underwriters and Certain Other Requesting Parties” issued by the American Institute of Certified Public Accountants (AICPA), as amended and integrated by SAS 76, on a registration statement that could be filed with the SEC, which will include the Financials .

#### 4.2 [INTENTIONALLY LEFT BLANK]

#### 4.3 *Interim Management*

Except as otherwise provided in Schedule 4.3, Seller shall procure that during the Interim Period the Company will be conducted without entering into any agreement or incurring in any obligation, liability or indebtedness or taking any other action which exceeds the Ordinary Course of Business or which may reasonably be expected to cause any of the representations or warranties of the Seller contained in this Agreement to become materially untrue or incorrect. In particular, the Company:

- (i) will not acquire, sell, transfer, pledge, mortgage, encumber, lease or otherwise dispose of any fixed tangible or intangible asset or property for an amount exceeding Euros 25,000 per single transaction and Euros 250,000 in the aggregate;
- (ii) will not acquire any real estate;
- (iii) will not acquire, nor dispose of, in any form, participations in the equity of other companies;
- (iv) will not acquire any business, or dispose of the Business or any segment of the Business;

- (v) will not issue or agree to issue a guarantee, indemnity or any other agreements aimed to secure, or incur financial or other obligations of Persons other than Loquendo;
- (vi) will not approve nor make any stock offering or other change in its capital structure involving the issuance of new shares or purchase or otherwise acquire any interest in its own equity;
- (vii) will not change its accounting methods, principles or practices, unless such change is provided by mandatory applicable law;
- (viii) will not (aa) terminate, or otherwise modify, the terms and conditions of the Material Contracts (as defined in article 7.13 (a), nor (bb) will it enter into new agreements which would fall into such a definition, save for any renewal thereof, nor (cc) will it grant to any third party any exclusive right to or with respect to any Intellectual Property Rights owned by or licensed to the Company, nor (dd) will enter into any agreements which include any exclusivity obligations, non-compete, most favorite nation pricing or other material restriction on the operation or scope of its Business;
- (ix) will not make any change (whether immediate, conditional or prospective) to, or grant or create, any additional allowance to employees, bonus or remuneration plan retirement, death or disability benefits scheme (including any change or addition affecting former directors, employees or consultants) other than those required by applicable laws and those approved prior to the date hereof as specified in Schedule 4.3(ix);
- (x) will not appoint or employ or make an offer of appointment or employment, to any new directors, employees, consultants or independent workers at an annual salary or rate of remuneration, save for as indicated in Schedule 4.3(x);
- (xi) will not decide, pay or make any dividend or other distribution or capital reduction;
- (xii) will not delay or accelerate the payment of any amount due, respectively, to or by its suppliers or customers or solicit or agree to the extension or acceleration of the payment terms otherwise applicable;
- (xiii) will not incur, outside of the Ordinary Course of Business, any expenditure or financial liability;
- (xiv) will not agree or undertake to do any of the foregoing.

It is understood that Loquendo will be entitled to take any action exceeding the Ordinary Course of Business described therein with the Buyer's written consent, whose consent shall not be unreasonably withheld. When seeking such consent, the Seller or the Company shall provide the Buyer with sufficient anticipation all necessary information to take a timely and informed decision. The Buyer shall provide a written response within five (5) Business Days from the relevant written request, failing which the Buyer shall be deemed to have consented and, accordingly, Loquendo shall be entitled to proceed with the action proposed to be taken.

4.4 *Actions prior to Closing*

- a) In order to allow the Other Shareholder to exercise the Tag-Along Right, the Seller shall deliver to the Other Shareholders, within 5 (five) Business Days of the date hereof, a notice in the form attached hereto as Schedule 4.4(a).
- b) The Seller shall cause the directors of Loquendo, and use its reasonable efforts to cause the effective statutory auditors and the alternatives statutory auditors of Loquendo, to resign or otherwise cease (however at no cost for the Company or the Buyer) from any office in Loquendo with effect from Closing Date.
- c) The Buyer acknowledges that the Seller has issued in the interest of the Company the guarantees, comfort letters and others similar commitments listed in Schedule 4.4(c) (the “**Guarantees**”). On or prior to the Closing Date, the Buyer shall cooperate with Seller to procure that the Seller be unconditionally released by the Guarantees with effect on the Closing Date by substituting the Guarantees effective on the Closing Date. In the event any of the beneficiaries of the Guarantees will not accept such substitution, Buyer and Seller shall agree in good faith a counter-guarantee to be released on the Closing Date by the Buyer in order to fully indemnify the Seller’s obligation under such Guarantees.
- d) On or prior to the Closing Date, the insurance coverage listed in Schedule 4.4(d) shall automatically expire as a consequence of the change of control of the Company. The Seller will cooperate with the Buyer in order to allow the Company to continue to benefit of such insurance cover (whose costs will be borne by the Company itself or by the Buyer as from the Closing Date), if so requested by the Buyer in writing prior to such expiry.
- e) The Seller shall cause the Company and the parties mentioned in Schedule 4.4(e) to terminate at no cost for the Company the agreements mentioned in that Schedule (the “**Intercompany Agreements**”), except for the services that the Buyer has asked to maintain in force after the Closing Date at the same terms and conditions and for a transitional period of time, which shall be governed by the transitional services agreement attached hereto as Schedule 4.4(e2).
- f) The Seller shall ensure that all financial arrangements existing between any of the TI Companies on the one hand and the Company on the other hand, whose list is attached hereto as Schedule 4.4(f) shall be fully settled and terminated at the Closing Date.

- g) The Seller, in the event the Other Shareholders have exercised the Tag-Along Right, shall promptly deliver to the Buyer the notice received from the Other Shareholders according thereto.
- h) On or prior to Closing, the Seller and the Company shall have executed a commercial agreement reflecting the terms summarized in Section 11.3 below.

## 5. **The Closing**

### 5.1 *Place and Date of Closing*

The Closing shall take place at the offices of the Seller in Rome, Corso Italia, 41, on the fifth (5th) Business Day after the date of a written notification sent by the Seller to the Buyer to such effect promptly following the satisfaction of the condition precedent mentioned in section 4.1 of this Agreement (the “**Closing Date**”), or such other place, date or time the Parties may determine by written agreement.

### 5.2 *Activities at the Closing*

In addition to any other action to be taken and to any other instrument to be executed and/or delivered pursuant to this Agreement, at the Closing:

- (a) the Buyer shall:
  - (i) pay to the Seller the Estimated Purchase Price in accordance with Section 3.2;
  - (ii) in the event the Other Shareholders have exercised the Tag-Along Right, pay to the Other Shareholders the purchase price for the Other Shares, it being equal to the same per share price of the TI Shares;
  - (iii) execute and deliver and/or cause to be executed and delivered such other instruments as may be necessary, under applicable law, to acquire the full and unencumbered ownership of the Shares;
  - (iv) deliver to the Seller a written statement, substantially in the form attached hereto as Schedule 5.2(a)(iv) whereby it shall undertake to abstain from acting against present and past directors and statutory auditors of the Company in connection with their capacity as such — this undertaking to exclude claims based on willful misconduct or gross negligence — and shall therefore undertake to indemnify each such individual in case of breach of its undertaking to abstain;

- (v) execute and deliver and/or cause to be executed and delivered the guaranties, comfort letters and others similar commitments necessary in order to discharge TI, and its Affiliates, to the fullest possible extent from the obligations set forth in the Guarantees;
  - (vi) in the context of a shareholders' meeting of the Company to be held at Closing, vote to release and discharge, to the maximum extent permitted by law, the directors and statutory auditors of Loquendo from and against any and all liabilities arising from their holding of the offices as, respectively, directors and statutory auditors of Loquendo up to the Closing Date;
- (b)** the Seller shall:
- (i) in the event the Other Shareholders have not exercised the Tag-Along Right deliver to the Buyer a written declaration, in the form attached hereto as Schedule 5.2(b)(i), whereby Seller certifies that the Tag-Along Right has not been exercised by the Other Shareholders;
  - (ii) deliver to the Buyer the certificates representing the TI Shares, duly endorsed;
  - (iii) execute and deliver such other instruments as may be necessary, under applicable law, to vest in the Buyer the full ownership of the TI Shares free of any Encumbrance;
  - (iv) cause Loquendo to register the Buyer in its shareholders register as the full and unencumbered owner of the TI Shares;
  - (v) deliver to the Buyer resignation letters of Loquendo Board members and statutory auditors, effective on the Closing Date, confirming that they have no claims for compensation for termination, loss of office or otherwise, with the exception of the compensation due to the statutory auditors according to their mandates, such letters substantially in the form set forth in Schedule 5.2(b)(iv);
  - (vi) procure the holding of an immediately subsequent shareholders' meeting for the Buyer to appoint directors in lieu of the ones who shall have resigned or otherwise ceased from office and, where applicable, to appoint statutory auditors in lieu of the ones who shall have resigned or otherwise ceased from office.
  - (vii) deliver to the Buyer a specific Schedule which will update, or integrate, the exceptions to the representations and warranties mentioned in Section 7 for the purposes of Section 9, insofar as such changes are



required as a result of events occurring subsequent to the date hereof (it being understood that the mere discovery of events following the date hereof shall not constitute a basis for any such change to the extent that the event occurred or existed prior to the date hereof) which would render any representation or warranty inaccurate or incomplete at any time after the date of this Agreement until the Closing Date. However, it is understood by the Parties that supplemental information set forth in such Schedule shall not be deemed to avoid or cure any misrepresentation or breach of warranty and does not negate any indemnity hereunder.

All actions and transactions set forth in this Section 5.2 shall be regarded as one and single transaction so that no action or transaction shall be deemed to have taken place if and until all other actions and transactions constituting the Closing shall have taken place as provided in this Agreement. It is agreed that in the event any of the Parties will not attend the Closing after the conditions precedent (if any) having been met, the other Party shall be free to start an action pursuant to article 2932 of the Italian civil code (specific performance).

### 5.3 *Transfer of Title*

Upon the occurrence of the Closing in accordance with Section 5 herein, the Buyer will acquire full ownership and good and marketable title to the TI Shares as of the Closing Date.

## **6. Post — Closing Covenants of the Buyer**

- (a) After the Closing Date, upon Seller's reasonable request, Buyer shall cause the Company and its representatives and counsel to cooperate with Seller and its representatives and counsel for purposes of permitting Seller to address and respond to any matters that arise as a result of or otherwise related to Seller's prior ownership of the Company, whether or not related to this Agreement, including any assets, liabilities or other matters related to the Company that are retained by Seller and any claims made by or against Seller, whether involving any Public Authority or third party.

Such cooperation shall include (i) assisting Seller in connection with any actions, including preparation for any actions such as discovery, depositions and similar activities, and (ii) providing Seller with financial information and supporting documentation relating to the Company, reasonably requested by Seller to prepare consolidated financial statements covering the period prior to Closing. Buyer's obligations under this Section 6(a) are in addition to Buyer's other obligations to cooperate with Seller contained in this Agreement.

- (b) The Buyer agrees to hold all of the books and records of the Company existing on the Closing Date and not to destroy or dispose of any thereof for the period required by applicable law.

- (c) The Buyer hereby agrees that, starting from the Closing Date, it shall cause the Company to cease any direct or indirect use (whether such use is formalized in writing or not) of the names, trademarks or logos of the TI Companies, as well as any reference thereto. However it will not constitute a violation of this clause the use of such names, trademarks or logos for a 30 (thirty) day period following the Closing Date if such use cannot be stopped at the Closing Date with the reasonable efforts of the Buyer.
- (d) The Buyer, based on its strategic and industrial plans, undertakes that the Company, becoming part of its organization, will be provided with the resources and expertise necessary to prosper as a key development and competence centre in the speech technologies solutions, also by strengthening — to the extent possible — the collaboration with the research & technology pole of the Italian academic institution and, in particular, with the *Politecnico* of Turin.

The Buyer, therefore, does not anticipate any reduction of the overall level of the Company's activity, changes of overall market conditions or the Company's operational state and undertakes, (x) for a period of 18 months of the Closing to keep the Company's headquarters and premises in Turin area and (y) for a period of 12 months of the Closing not to cause the Company to:

- (i) start and/or implement any action aimed to (a) the collective dismissal of the Company's work force or (ii) making recourse to the procedure established by law n°223/1991 (*procedura di mobilità*), unless it has been priorly reached an agreement with the Unions which provides, inter alia, that such procedure may be implemented only in case of agreement of the workers involved;
- (ii) dismiss any employees of the Company except for cause (*licenziamento per giusta causa*);

it being understood and agreed that the Company is always allowed to facilitate the voluntary resignation of the Company's employees and/or reach an agreement with the Unions directed to reduce the Company's workforce, save as provided for in paragraph (i) above.

Furthermore, after expiration of such 12 months period, and for a further period of 6 months therefrom, Buyer undertakes not to start or implement any major restructuring and/or drastic changes to the organization or employment structure of the Company.

**7. Representations and Warranties of the Seller**

The Seller hereby makes the following representations and warranties to the Buyer, each of which shall be true and correct also on the Closing Date:

*7.1 Organization and Standing*

TI is a company duly incorporated, validly existing and in good standing under Italian law, and is not subject, nor likely to become subject, to any bankruptcy or insolvency procedure applicable to it, nor to any other similar proceedings which may lead to the claw back of the transaction ruled herein.

*7.2 Authorization*

(a) All corporate acts and other proceedings required to be taken by or on behalf of TI to authorize it to enter into and to carry out this Agreement have been duly and properly taken, and this Agreement has been duly executed and delivered by TI and constitutes a valid and binding obligation of the Seller enforceable against it in accordance with its terms.

(b) No application to, or filing with, or consent, authorization or approval of, or license, permit, registration, declaration or exemption by, any governmental or public body or authority is required for TI to execute and perform this Agreement.

*7.3 No Conflict*

The execution and delivery of this Agreement and the consummation of the transactions contemplated hereby will not conflict with, or result in the breach of, or constitute a default under, the articles of incorporation and the By-laws of TI or the Company, or any legal, regulatory (to this respect, without prejudice to Section 7.2), or contractual obligation applicable to TI or the Company (save for any change of control clause contained in the Intercompany Agreements, the Material Contracts and/or the Company's Agreements) or any decision rendered by ordinary or administrative courts or by arbitrators, applicable to TI or the Company, as the case may be, which breach or decision might materially adversely affect the transaction ruled herein.

*7.4 Ownership of the Shares*

(a) TI Shares and the Other Shares constitute the entire share capital and voting rights of the Company.

(b) TI has good and marketable title to the TI Shares, free and clear of any Encumbrances and has the full right, power and authority to sell, assign, transfer and deliver the TI Shares in accordance with the terms of this Agreement.

- (c) Upon the occurrence of the Closing, in accordance with Section 5, the Buyer will acquire full and unencumbered ownership of the TI Shares.

*7.5 Compliance with law*

The Seller is in compliance with any laws and regulations to which it is subject in all material respect.

To the knowledge of the Seller, the Company is in compliance with any laws and regulations to which it is subject in all material respect.

*7.6 Capitalization*

- (a) The authorized share capital of the Company is indicated in Schedule 7.6(a) and is fully paid in.
- (b) There are no options, warrants, conversion or subscription rights, agreements, contracts or commitments of any kind obligating the Company, conditionally or otherwise, to issue or sell any new shares of capital stock, or instrument convertible into or exchangeable for any shares, or to repurchase or redeem any of its shares.
- (c) The Company is a company duly incorporated, validly existing and in good standing under Italian law, and is not subject to liquidation or to any insolvency procedures.

*7.7 Reference Financial Statements*

- (a) The Reference Financial Statements have been prepared and audited in accordance with the Italian Accounting Principles and Practices and therefore reflect all liabilities of the Company which should be recorded according to the Italian Accounting Principles and Practices and present a true and fair view of the financial position of the Company at December 31, 2010.
- (b) To the knowledge of the Seller since December 31, 2010 through the date hereof, the Company has conducted its activity in a good-faith and in the Ordinary Course of Business manner and in particular, since December 31, 2010, the Company has not
- (i) acquired, sold, transferred, pledged, mortgaged, encumbered, leased or otherwise disposed of any fixed tangible or intangible asset or property nor it has incurred any expenditure or financial liability for an amount

exceeding Euros 25,000 per single transaction and Euros 250,000 in the aggregate, save as indicated in Schedule 7.7(b)(i);

- (ii) acquired any real estate;
  - (iii) acquired, nor disposed of, in any form, participations in the equity of other companies;
  - (iv) acquired, or disposed of, any business or segment of business;
  - (v) given or agreed to give a guarantee, indemnity or other agreement to secure, or incur financial or other obligations of Persons other than Loquendo;
  - (vi) approved nor made any stock offering or other change in its capital structure involving the issuance of new shares or purchase or otherwise acquired any interest in its own equity;
  - (vii) changed its accounting methods, principles or practices, unless such change was provided by mandatory applicable law;
  - (viii) terminated, or otherwise modified, the terms and conditions of the Material Contracts (as defined in article 7.13 (a), or entered into new agreements which would fall into such a definition, save for any renewal thereof and for those listed in Schedule 7.7(b)(viii);
  - (ix) made any change (whether immediate, conditional or prospective) to, or granted or created, any additional allowance to employees, bonus or remuneration plan retirement, death or disability benefits scheme (including any change or addition affecting former directors, employees or consultants) other than those required by applicable laws and those listed in Schedule 7.7(b)(ix);
  - (x) appointed or employed or made an offer of appointment or employment, to any new directors, employees, consultants or independent workers at an annual salary or rate of remuneration in excess of Euros 30,000;
  - (xi) decided, paid or made any dividend or other distribution or capital reduction, save as indicated in Schedule 7.7(b)(xi);
  - (xii) agreed or undertaken in writing to do any of the foregoing.
- (c) The Company has no off-balance sheet commitments other than those which have been entered into by the Company in the Ordinary Course of Business.

#### 7.8 *Assets*

- (a) The Company (except as indicated in Schedule 7.8(a)) has good and valid title, free and clear of any Encumbrances, to all assets owned by it as reflected in the Reference Financial Statements (the "Assets").

- (b) The Company is in lawful and exclusive possession of the Assets and has no knowledge of any expropriation proceeding pending or threatened in writing with respect to any such Assets which would preclude or materially impair their use.

Each Asset is fit for its respective current use (tear and wear excepted).

*7.9 Intellectual Property*

- (a) The Company (except as indicated in Schedule 7.9(a)) is the sole, exclusive and registered (where applicable) owner of, and/or has all rights to use, the Intellectual Property described in Schedule 7.9(a) which is free of any Encumbrances. Except for the Intellectual Property described in Schedule 7.9(a), no other Intellectual Property is used by the Company to run its business the way it is presently conducted.
- (b) Except as otherwise provided in Schedule 7.9(b), there is no proceeding pending against the Company which may adversely affect the Company's ownership or use (as the case may be) of the Intellectual Property described in Schedule 7.9(a).
- (c)
- (i) The Company owns or has a valid right to use all the Intellectual Property that is required for the conduct of its business as it is presently carried out. The Company has not received any written claim or notice from any third party alleging that the Company has infringed or currently infringes any third party's intellectual property rights.
- (ii) To the knowledge of the Seller, there is no third party's conduct which infringes upon or otherwise violates in any material respect the Intellectual Property described in Schedule 7.9(a).
- (iii) To the knowledge of the Seller, except as otherwise provided in Schedule 7.9(c)(iii), all material application, registration, maintenance and renewal fees in connection with the Intellectual Property and applications thereof have been paid and all material documents and certificates in connection with such Intellectual Property have been filed and maintained with the relevant authority.
- (iv) Except as otherwise provided in Schedule 7.9(c)(iv), no licenses or other rights on the Intellectual Property described in Schedule 7.9(a) have been granted or are in force in favor of any third party.
- (v) Except as set forth in Schedule 7.9(c)(v), to the extent that any

Technology has been developed or created independently or jointly by any Person other than the Company, for which the Company has, directly or indirectly, provided consideration for such development or creation, and such Technology is used in or necessary to the conduct of Company's business as presently conducted or currently contemplated to be conducted by the Company, the Company has an agreement with such Person with respect thereto, and the Company thereby has obtained ownership of, or a right of use, all such Technology and associated Intellectual Property by operation of law or by valid assignment. All rights in, to and under all Technology and Intellectual Property Rights created by the Company's employees for or on behalf or in contemplation of the Company during their employment with the Company, have been duly and validly assigned to the Company, by contract or by operation of law.

- (vi) Except as set forth in Schedule 7.9(c)(vi), the Company has not transferred ownership of, or granted any exclusive license of or exclusive right to use, sell, license, manufacture or otherwise distribute, or authorized the retention of any exclusive rights to use, any Technology or Intellectual Property Rights, to any other Person.
- (vii) This Agreement will not result in: (i) the Company or Buyer granting to any third party any right to or with respect to any Intellectual Property Rights owned by the Company, (ii) the Company or Buyer being bound by or subject to, any exclusivity obligations, non-compete or other material restriction on the operation or scope of their respective businesses, or (iii) the Company or Buyer being obligated to pay any royalties or other material amounts to any third party in excess of those payable by any of them, respectively, in the absence of this Agreement or the transactions contemplated hereby.
- (viii) The Company has taken reasonable steps under Italian applicable law to protect the Company's rights in proprietary and confidential information, trade secrets and know-how of the Company or provided by any other Person to the Company.
- (ix) Neither the Company nor any Person acting on the Company's behalf has disclosed, delivered or licensed to any Person, other than an escrow agent, agreed to disclose, deliver or license to any Person, other than an escrow agent, any software source code constituting Company Intellectual Property ("**Company Source Code**").
- (x) The execution of this Agreement and the consummation of the transactions contemplated hereby (with or without notice or lapse of

time or both) will not, or could reasonably not be expected to, result in the disclosure or delivery by or on behalf of the Company of any Company Source Code.

- (xi) Schedule 7.9(c)(xi) lists all unsettled current and future payment or other compensation claims, owed by the Company to any Person, including without limitation employees and managers of the Company, for assignments of inventions or Intellectual Property Rights.

#### 7.10 Taxes

- (a) The Company has timely filed all relevant Tax returns, and all such Tax returns are true, correct and complete. All Taxes in respect thereof have been fully paid or adequately reserved for.
  - (i) No Tax claims are pending against the Company and no written notice of any such claim was received by the Company. No issues have been raised in any examination by any Tax authority with respect to the Company which reasonably could result in a deficiency or increase in Tax burden for any fiscal year so examined.
  - (ii) The Company has withheld and paid all Taxes required to have been withheld and paid in connection with amounts paid or owing to any Company's employee, former employee, independent contractor, creditor, stockholder, or other third party.
  - (iii) All records, accounts and other documents which the Company is required to keep for Tax purposes have been duly kept at the Company's premises or are otherwise readily accessible to it.

#### 7.11 Employees

The personnel employed by the Company ("**Employees**") is listed in Schedule 7.11 which indicates the identification numbers, duties, seniorities, annual compensations and terms of office (i.e. temporary vs. indefinite and full time vs. part time). The Employees are regularly recorded in the appropriate books of the Company in accordance with applicable laws and regulations.

- (i) The Company has made all the filings and taken all the actions required to be made or taken in respect of the Employees under applicable social security, labour and welfare laws and regulations, and such filings are true, correct and complete.



- (ii) All payments — including Social Security Charges — due under applicable laws and regulations in respect of the Employees have been fully paid or adequately reserved for.
- (iii) The Company has not breached or otherwise failed to comply with all applicable labour and social security laws and provisions of any collective bargaining or union contract or any individual or company labour agreement executed with the Employees.
- (iv) No claims or investigations are pending against the Company which reasonably could result in a deficiency or increase of Social Security Charges.
- (v) With the exceptions of the monetary benefits listed in Schedule 7.11(v), there are no monetary benefits payable to the Employees.
- (vi) Except as otherwise provided in Schedule 7.11(vi), neither the Seller nor the Company have undertaken to increase the rates of remuneration or to grant a bonus or advantage of any kind or pay any compensation to any of the Company's employees after the date hereof other than as imposed by applicable Law or by the Collective Agreements.

#### *7.12 Litigation and Claims*

Except as otherwise disclosed in Schedule 7.12, the Company is not a party to any pending litigation or claims, whether before the ordinary courts or before administrative, tax or other courts or arbitrators.

#### *7.13 Contracts*

Schedule 7.13 contains a complete and correct list of the contracts to which the Company is a party having:

For active contracts, i.e. contracts where the Company receives a monetary consideration in exchange for its products or services

a value in excess of (i) Euro 100,000 (one hundred thousands) based on aggregate turnover per client as of 2010 (as at December 31) and (ii) Euro 50,000 (fifty thousands) based on aggregate turnover per client as of 2011 (as at June 30) and (iii) agreements having a minimum guaranteed turnover for 2011 of Euro 100,000 (one hundred thousands)

For passive contracts, i.e. contracts where the Company pays a monetary consideration in exchange for products or services

a value in excess of (i) Euro 50,000 (fifty thousands), based on aggregate expenditures per supplier as of 2010 (as at December 31) and (ii) Euro 25,000 (twenty five thousands) based on aggregate expenditures per supplier as of 2011 (as at June 30) and (iii) agreements having minimum guaranteed expenditures for 2011 of Euro 50,000 (fifty thousands)

(together, the “**Material Contracts**”).

- (i) To the knowledge of the Seller, each Material Contract is in full force and effect in all material respects and enforceable against each party thereto except to the extent that any failure of specific clauses of any Material Contract to be enforceable could not be foreseen as a cause of termination of such Material Contract. The conclusion and consummation of this Agreement shall not give to any party of such Material Agreements the right to terminate such Material Agreement (save for any Intercompany Agreements and for any change of control clauses contained in the agreements contained in Schedule D.
- (ii) Except as otherwise disclosed in Schedule 7.13 (ii) the Company is not in default in respect of payments due under any Material Contracts with its suppliers, nor is it likely to incur in any liabilities for delayed payments in respect thereof.
- (iii) Except as otherwise disclosed in Schedule 7.12, none of the Material Contracts is subject to any pending litigation nor the Company has received notices in writing directly threatening the filing of judicial claims or to terminate any Material Contract.

Before the date of this Agreement, Buyer has had access to the Company’s agreements contained in Schedule 7.13(a) (the “**Company’s Agreements**”). The Seller represents and warrants that, to the knowledge of the Seller, the Company’s Agreements are true and complete and, except as listed in Schedule 7.13(a), they have not been adversely amended in any material respect.

Apart from the Company’s Agreements, to the knowledge of the Seller no agreements to which the Company is a party contain any clause, provisions, covenants or however issues, in the areas of IP or non-compete or most favored nation clauses, that would materially adversely impact the enterprise value of the Company.

*7.14 Insurance*

- (a) The Company maintains the insurance policies listed in Schedule 7.14(a), that are those required and customary in connection with the conduct of its business. Premiums due under all such insurance policies have been regularly and timely paid or reserved for.
- (b) All such insurance policies are in full force and will be automatically terminated as a direct consequence of Closing. The Company has not received notice of cancellation or termination or non-renewal of any such insurance policies.

*7.15 No Brokers*

Neither the Seller nor the Company have incurred any liability for any brokerage, finder's or similar fees or commissions in connection with the transactions contemplated hereby, the payment of which could be validly claimed from the Buyer, its Affiliates or the Company.

*7.16 No derivatives*

The Company is not a party to any hedging agreements or other derivatives, except for hedging agreements entered into in the Ordinary Course of Business by the Company with financial institutions for covering the risk of fluctuation of the exchange rates with respect to the sale of services or goods by the Company.

*7.17 No other Representations and Warranties*

- (a) As the Buyer represented to have a deep knowledge of Loquendo and its business perspectives as well as a clear and good understanding of its business and products, and of the market in which the Company operates, the Parties have agreed that the Seller will grant the Buyer with a set of representations and warranties on the Company standard for transactions of this nature, but limited to those listed here above. Therefore no express or implied representation or warranty other than those expressly provided in this Section 7 is given or will be given by or on behalf of the Seller or the Company to the Buyer.
- (b) The representations and warranties set forth above are made to the Buyer subject only to the disclosures contained herein, and the Schedules attached to this Agreement, including Schedule D, which shall be deemed to constitute an exception or to otherwise limit the scope of the Seller's representations and warranties.

**8. Representations, Warranties of the Buyer**

The Buyer hereby makes the following representations and warranties to the Seller, each of which shall be true and correct also on the Closing Date.

*(a) Organization and Standing*

The Buyer is a corporation duly incorporated, validly existing and in good standing under the laws of the State of Delaware, U.S.A..

*(b) Authorization*

- (i) All corporate acts and other proceedings required to be taken by or on behalf of the Buyer to authorize the Buyer to enter into and to carry out this Agreement have been duly and properly taken, and this Agreement has been duly executed and delivered by the Buyer and constitutes a valid and binding obligation of the Buyer enforceable against the Buyer in accordance with its terms.
- (ii) No application to, or filing with, or consent, authorization or approval of, or license, permit, registration, declaration or exemption by, any governmental or public body or authority is required for the Buyer to execute and perform this Agreement.

*(c) No Conflict*

The execution and delivery of this Agreement and the consummation of the transactions contemplated hereby will not conflict with, or result in the breach of, or constitute a default under, the articles of incorporation or the By-laws of the Buyer.

*(d) No Brokers*

Buyer has not incurred any liability for any brokerage, finder's or similar fees or commissions in connection with the transactions contemplated hereby, the payment of which could be validly claimed from the Seller or any of their Affiliates.

*(e) Funding*

Buyer will have at Closing sufficient funds to pay in immediately available funds in Euro the Estimated Purchase Price, all amounts necessary to make the payments, to consummate transactions and to perform all its other obligations contemplated by this Agreement.

*(f) Antitrust*

The Buyer represents and warrants to the Seller that the completion of the transaction contemplated by this Agreement does not require any antitrust clearance by the

Commission of the European Union or by the competent authorities in each country of the European Union or the USA.

*(g) Compliance with law*

The Buyer is in compliance with any laws and regulations to which it is subject in all material respect.

*(h) No Reliance*

In connection with entering into this Agreement: (i) the Buyer is not relying (for purposes of entering into this Agreement or otherwise) upon any advice, counsel document and analysis (whether written or oral) of the Seller or the Company nor on any guarantee, or representation as to the expected or projected success, profitability, return, performance or result of the Company other than the representations and warranties contained in this Agreement; (ii) the Buyer has made its own decisions with respect to entering into this Agreement and consummating the transaction contemplated hereunder exclusively based upon its own judgment and upon any advice from its advisers as it has deemed necessary and not upon any view expressed by the Seller or the Company (directly or indirectly through any other Person); and (iii) the Buyer is entering into this Agreement with a full understanding of its terms and conditions.

**9. Indemnification by the Seller**

**9.1 Undertaking of the Seller**

9.1.1 Subject to the provisions of Sections 9.3 and 9.4 the Seller shall indemnify and hold harmless the Buyer in respect of the Losses incurred or suffered by the Buyer as a result of acts, omissions, facts or circumstances that represent a breach of any representations and warranties listed in Section 7 and/or any Seller's covenant contained in this Agreement, up to the amount of the Cap (other than covenants under Sections 4.3, 11.1, 11.2 and 11.3).

9.1.2 For the purposes of this Agreement "Loss" shall mean any direct cost, damage or liability, including reasonable legal fees incurred in the investigation, prosecution and defence of claims; provided, however, that any indirect Losses shall not constitute a Loss for purposes of this Agreement.

**9.2 No Other Remedy**

The rights and remedies provided in Section 9.1 shall be *in lieu* of any and all other right or remedy of the Buyer, provided by law (in contract and/or in torts) or otherwise, however arising in connection with any breach of the representations and warranties covenants

and/or obligations (other than covenants under Section 11.1 and 11.2) of the Seller contained in this Agreement. Notwithstanding anything to the contrary contained in this Agreement, no breach or inaccuracy of any covenants, (other than covenants under Section 4.3(iv), 4.3(viii) representations or warranties of the Seller contained in this Agreement will give rise to any right on the part of the Buyer to rescind or terminate this Agreement.

### **9.3 Exclusions, Deductions, Limitations and Monetary thresholds**

#### *9.3.1 Exclusions*

The Seller shall not be responsible under Section 9.1:

- (a) in respect of any actual or alleged breach of the representations and warranties referred to herein which is notified by the Buyer to the Seller later than 18 months of the Closing Date except for (i) any Claims under any Seller's Warranties and Representations concerning the matters set forth in Sections 7.4 (Ownership of the Shares), which shall be barred upon expiration of the tenth anniversary of the Closing Date, and (ii) any Claims under any Seller's Warranties and Representations set forth in Sections 7.5 (Compliance with Law), 7.10 (Taxes) and 7.11 (Employment Matters), which shall be time-barred only after 30 (thirty) Business Days following the date on which any claim by the competent authorities or other interested party or parties in respect of the matters covered by such Sellers' Warranties and Representations is finally barred by any applicable statute of limitations;
- (b) if the liability for which indemnification is sought may be attributed to any changes in accounting or tax methods, applicable laws, regulations, administrative regulations, modifications of the scope of coverage of the insurance policies of the Company or changes of other policies of the Company after the Closing Date;
- (c) in connection with facts or matters which are disclosed in this Agreement (including, for sake of clarity, any of its Schedules) or in Schedule D;
- (d) in relation to any additional Losses deriving from the situation giving rise or likely to give rise to a liability, which could have been avoided if the Buyer or the Company (as appropriate) had used, upon becoming aware of such situation, any reasonable actions in order to limit or mitigate such Losses;
- (e) without prejudice of what is provided in this Agreement, in respect of any contingent or potential liability, unless and until such liability has become actual and has been properly paid for by the Buyer or the Company in accordance with the procedure set forth in Section 9.4 or has become the subject matter of a final

and unappealable (judicial or arbitration) award, provided that the Buyer shall be entitled to raise a claim before the expiry of the period established by Section 9.3.1(a) for any contingent or potential liability (provided such potential liability is supported by a written request from the third party involved) which shall then remain valid and pending until actual payment, if any, notwithstanding the expiration of the applicable period as set forth in subparagraph (a) above.

#### *9.3.2 Deductions*

The amount of all indemnities payable by the Seller pursuant to Section 9.1 shall be further reduced by:

- (i) any fund and/or provision recorded in the Reference Financial Statements and/or in the Company's accounts relating to the category of event giving rise to indemnification; and
- (ii) the amount of any payment from third parties (whether insurance companies or otherwise) that the Buyer or the Company has actually received in connection with the event giving rise to indemnification.

#### *9.3.3 Limitations*

Subject to the provisions set forth in Sections 9.3.1 and 9.3.2, the amount payable by the Seller pursuant to Section 9.1 shall also be subject to the following limitations:

- (a) in case of any tax assessment that only results in the shifting of the tax burden from one fiscal year to another, any indemnification relating thereto shall be limited to the actual net and final cash cost thereof to the Company;
- (b) in case the Seller has indemnified the Buyer for a Loss suffered or incurred by the Company, the correspondent damage, if any, suffered by the Buyer because of the diminished value of the participation will not constitute a Loss to be indemnified;
- (c) if the same circumstance constitutes a breach of different representations and warranties, such circumstance will only be deemed as a breach of the representation and/or warranty which is more relevant;
- (e) in no event there will be a duplication of indemnification with respect to a breach of any of the representations and warranties made in this Agreement.

#### *9.3.4 Monetary thresholds*

- (a) The Seller shall not be liable:

- (i) if the amount due in connection with any single occurrence (or series of events of a similar nature) giving rise to liability pursuant thereto does not exceed Euro 35.000,00 (thirty five thousand);
  - (ii) until the aggregate of all amounts that would otherwise be due by the Seller (taking into account the amounts to be subsequently excluded pursuant to point (i) above) exceeds Euro 500,000 (five hundred thousand) (the “**Threshold**”), provided that, if such limit is exceeded, the Sellers liability shall be limited to the excess of half of the Threshold (i.e. Euro 250,000 (two hundred and fifty thousand).
- (b) In any event, and subject to above, the Seller’s maximum aggregate liability under Section 9.1 shall be limited to Euro 3,000,000.00 (three million) (the “**Cap**”), provided that the Cap shall not apply to any breach of the covenants under Sections 4.3, 11.1, 11.2 and 11.3 of this Agreement.

#### **9.4 Handling of Claims**

- (a) If any event occurs which could give rise to the Seller’s liability under Section 9.1 in respect of any warranties or representations contained herein, the following provisions shall apply:
- (i) the Buyer shall give prompt written notice to the Seller of such event and shall provide all reasonable particulars thereof within 40 (forty) Business Days of the occurrence of such event, upon penalty of forfeiture;
  - (ii) during a period of 30 (thirty) Business Days following the giving of a written notice to the Seller of the kind referred to under point (i) preceding, the Seller and the Buyer will attempt to resolve any differences which they may have with respect to any matters constituting the subject matter of such notice. If, at the end of such period, the Seller and the Buyer fail to reach agreement in writing with respect to all such matters, then all the matters as to which agreement is not so reached may, thereafter, be submitted to arbitration pursuant to Section 11.7 hereof.
- (b) If any claim, suit or proceeding (“**Claim**”) is asserted or commenced by any third party claimant (“**Third Party**”) against the Buyer or the Company, possibly resulting in the right of the Buyer to be indemnified pursuant to this Section 9, the Seller will be entitled to have one or more professionals at its own choice appointed to support the defense team and to identify the defensive strategy and actions with the other professionals appointed, if any, by the Buyer provided that in each such case the Seller and the Buyer respectively shall pay all their appointed professionals fees, out-of-pocket costs and expenses. In the event that a



settlement of a pending litigation is proposed by the Seller to the Buyer and/or the Company as being already acceptable to the relevant Third Party, and the Buyer does not approve it, no settlement will be entered into, but the Seller shall only be liable to reimburse and indemnify the Buyer and/or the Company, as appropriate, of an amount not exceeding the amount it proposed to settle for. Conversely, in the event that a settlement of a pending litigation is proposed by the Buyer and/or the Company to the Seller as being already acceptable to the relevant Third Party, and the Seller does not approve it, no settlement will be entered into, but the Seller will be liable to reimburse and indemnify the Buyer and/or the Company of any and all the amounts which should result payable by the Buyer and/or the Company at the end of the litigation, without such obligation being subject to the above monetary limitations.

**10. limitation of liability of the Buyer**

It is hereby agreed by the Parties that the maximum liability of the Buyer for the breach of its representations, warranties, covenants and obligations hereunder shall not exceed the amount of Euros 3 (three) million. Such limitation of liability shall in no event apply for the Buyer's representation under Section 8(f) and for the Buyer obligation to pay the Estimated Purchase Price and the Final Purchase Price.

**11. Further Covenants**

**11.1 Non Compete**

- (a) The Seller covenants and agrees that, for a period of three (3) years after the Closing Date, the Seller shall not, and shall procure that its Affiliates shall not:
- (i) engage in or carry on, within the geographical area encompassed (as of the date hereof) by the boundaries of the European Union, Switzerland, Asia and the Americas any business competing with the business of Loquendo as conducted on the date of this Agreement, namely any business in the field of development of speech technologies software, as better indicated in Schedule 11.1(a)(i) attached hereto (the "Business"), which has in the aggregate an annual turnover of Euros 3 (three) million;
  - (ii) acquire any interest in any partnership, joint venture, corporation (whether as lender or as investor) of more than two (2) percent of any class of the issued and outstanding securities of a listed corporation, or more than twenty (20) percent of any class of the issued and outstanding securities of a non listed corporation which has the Business as its core business.

(b) The Parties believe that the restrictions contained in Paragraph (a) preceding are reasonable and justified under the circumstances. However, should any Court or other authority of competent jurisdiction determine, at any time, any such restrictions to be unenforceable or unreasonable as to scope, territory or duration, such scope, territory or duration shall be deemed to be reduced to that declared or determined by said Court or other authority to be enforceable and reasonable. Each of the restrictions contained in Paragraph (a) are enforceable independently of each of the others and the validity of each shall not be affected if any others are deemed to be invalid.

(c) For the sake of clarity it is agreed by the Parties that the non compete restrictions contemplated by this Section 11 shall not apply (i) to any activity or business already carried out by the Seller and its Affiliates as of the date hereof, and (ii) to any direct or indirect interest in any partnership, joint venture, corporation (whether or not listed) owned by the Seller and its subsidiaries as of the date hereof and (iii) to any research project/program/initiative involving Italian Authorities and/or academic institution in the field of semantic.

#### **11.2 Non-Solicitation**

Save as otherwise agreed between the Parties, for a period of three (3) years from the date hereof Seller shall not, and shall cause any of its Affiliates not to, actively solicit or entice away any Employees from the Company. This however shall not prohibit Seller and its Affiliates from hiring an officer, a manager or an employee of the Company after such person responds to a general advertisement not targeted specifically at Company personnel.

#### **11.3 Business Stability — Three Year Commitment**

The Seller undertakes, for itself and its subsidiaries, and for a period of thirty-six months after the Closing Date, to buy (and to procure that its Affiliates buy) Company's products and services, on terms and conditions at least consistent with past practice, for an aggregate turnover equal to Euros 7,000,000.00, split, unless otherwise agreed between the Parties depending upon their business requirements, as follows:

- (i) Euros 2,500,000.00 until the first anniversary from Closing; and
- (ii) Euros 2,500,000.00 in the period between the first and the second anniversary from Closing; and
- (iii) Euros 2,000,000.00 in the period between the second and the third anniversary

from Closing;

Should the Seller and/or its Affiliates buy in any given period under paragraph (i), (ii) and (iii) above products and services for an aggregate turnover higher than the one referred to in such period, the excess turnover will be credited to the turnover for the subsequent period until the amount of Euros 7,000,000.00 is reached

The Seller hereby waives, for itself and its Affiliates and with immediate effect as from Closing, to any most favored nation or best pricing clause contained in any agreement between the Seller or its Affiliates and the Company with respect to other Company's clients located or anyway doing business in countries other than Italy, Brazil and Argentina. In Italy, Brazil and Argentina, however, such clauses shall apply only in relation to the products of the Company, their enhancements or replacements (including replacements marketed by Buyer). Any such clauses shall be automatically terminated as from the Closing Date.

## **12. Confidentiality and Announcements**

### **12.1 Confidentiality Obligations**

The Parties acknowledge and agree that all the confidentiality undertakings contained in the confidentiality agreement executed and exchanged by and between TI and the Buyer on April 12, 2011 (the "**Confidentiality Agreement**") will remain in full force and effect in accordance with its terms also after the date hereof.

### **12.2 Announcements**

All publicity, release or announcement concerning the execution or delivery of this Agreement, any of the provisions contained herein or the transactions contemplated hereby (including the consummation of the Closing) will be issued with the prior written consent of the Seller and the Buyer unless otherwise required pursuant to the provisions or requirements of any law enacted or rule issued by any governmental body or other regulatory or stock exchange authority having jurisdiction on any of them, subject to prior written notice to the other Party.

## **13. Miscellaneous Provisions**

### **13.1 Changes in Writing**

This Agreement (i) constitutes the entire agreement between the Parties with respect to the subject matter hereof and supersedes all prior agreements (if any) relating to the same matter; (ii) shall not be waived, changed, modified or discharged orally, but only by

an agreement in writing signed by both Parties.

### **13.2 Assignment Prohibited**

Neither Party may assign or otherwise transfer any of its rights, interests or obligations however arising under this Agreement without the prior written consent of the other Party.

### **13.3 Notices**

Any communication or notice required by, or otherwise connected to, this Agreement shall be made in writing and in the English language and shall be deemed to have been duly and validly delivered (i) in case of notice sent by letter, upon receipt of same, and (ii) in case of notice sent by fax, upon issue of the relevant transmission statement by the fax machine, addressed, in each case, as follows

a) if to the Seller, to it at:

Telecom Italia S.p.A.  
Corso Italia, 41  
00198 Roma  
Fax 06 91254907  
Attention to Mr. Vito Bonura

with copy to:

Telecom Italia S.p.A.  
Corso Italia, 41  
00198 Roma  
Fax 06 91863038  
Attention to Mr. Stefano D'Ovidio

(b) if to the Buyer, to it at :

Nuance Communications, Inc.  
One Wayside Road  
Burlington, MA 01803  
Fax: (781) 565-5001  
Attention to Executive Vice President, Corporate Strategy and Development

with copy to :

Bird & Bird  
via Borgogna n.8  
20122 — Milano  
Fax: 02.30356011

Attention to Mr. Edoardo Courir

(c) if to the Company, to it at :

Via A. Olivetti, 6  
10123 Torino  
Fax: 06 91253619

Attention to Mr Davide Franco

or at such other address and/or fax number as either Party may hereafter provide to the others by written notice, as herein provided.

#### **13.4 Further Assurances**

The Parties hereby agree to execute and deliver all such instruments and documents and to perform all such acts and do all such other things as may be necessary for the purposes of this Agreement.

#### **13.5 Taxes and Other Expenses**

Except as otherwise expressly provided in other Sections of this Agreement, any cost, Tax, or charge arising in connection herewith, or with the consummation of the purchase and sale under the terms and conditions contemplated hereby, shall be borne and paid as follows:

- (i) all capital gain taxes due as a consequence of the sale of the Shares shall be borne and paid for by the Seller;
- (ii) the Buyer and the Seller shall each pay the fees, expenses and disbursements owed to their respective auditors, advisers and legal counsels;
- (iii) all other costs, expenses, taxes, duties and charges, including without limitation costs, expenses, taxes, duties and charges related to the transfer of the Shares shall be borne and paid for by the Buyer.

#### **13.6 Severability**

If any provision of this Agreement which is not material thereto shall be held invalid, illegal or unenforceable, the validity, legality or enforceability of the other provisions of this Agreement shall not be affected thereby, and the Parties shall negotiate in good faith a valid, legal and enforceable substitute provision as similar as possible to the provision at issue.

### 13.7 Governing law, Arbitration Clause and Election of Domicile

#### (a) Applicable Law

This Agreement and the rights and obligations of the Parties hereunder shall be governed by, and construed and interpreted in accordance with, the Italian law.

#### (b) Arbitration Clause

All disputes arising out of or in connection with this Agreement shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by a panel of three arbitrators, irrespective of the numbers of the parties, appointed in accordance with the said Rules, who shall decide based on the law and not *ex aequo et bono*; provided, however, that the Courts of Milan, Italy shall have jurisdiction as to specific performance or injunctive relief.

The seat of the arbitration shall be Paris, France. The language of the arbitration shall be in English.

#### (c) Election of Domicile

The Seller and the Buyer hereby designate their respective addresses for the giving of notice, as set forth in Section 13.3, as their respective domiciles at which service of process may be made in any legal action or proceedings arising hereunder.

### 13.8 List of Schedules

| Number          | Schedule                                       |
|-----------------|--|
| Schedule 0.01   | Powers of TI                                   |
| Schedule 0.02   | Powers of Nuance                               |
| Schedule D      | DVD containing the data room documents         |
| Schedule E      | Art. 6 of the Company's by-laws                |
| Schedule F      | Reference Financial Statements of the Company  |
| Schedule 3.1    | Criteria for calculating the ENFP and the CNFP |
| Schedule 4.1    | Letter from the Independent auditors           |
| Schedule 4.3    | Exceptions to Interim management               |
| Schedule 4.4(a) | Tag-Along Right notice                         |

| <b>Number</b>         | <b>Schedule</b>  |
|-----------------------|--|
| Schedule 4.4(c)       | List of Guarantees   |
| Schedule 4.4(d)       | List of Insurance Policies   |
| Schedule 4.4(e)       | List of Intercompany Agreements and parties related thereto                                    |
| Schedule 4.4(e2)      | Transitional Services Agreement  |
| Schedule 4.4(f)       | List of intragroup financial arrangements  |
| Schedule 5.2(a)(iv)   | Buyer's statement relating to present and past directors and statutory auditors of the Company |
| Schedule 5.2(b)(i)    | Statement of the Seller  |
| Schedule 5.2(b)(iv)   | Form of resignation letters  |
| Schedule 7.6(a)       | Authorized share capital of the Company  |
| Schedule 7.7(b)(i)    | Exception to Seller's representation under Section 7.7(b)(i)                                   |
| Schedule 7.7(b)(viii) | Exception to Seller's representation under Section 7.7(b)(viii)                                |
| Schedule 7.7(b)(ix)   | Exception to Seller's representation under Section 7.7(b)(ix)                                  |
| Schedule 7.7(b)(xi)   | Exception to Seller's representation under Section 7.7(b)(xi)                                  |
| Schedule 7.8 (a)      | Exception to Seller's representation under Section 7.8   |
| Schedule 7.9(a)       | List of Intellectual Properties  |
| Schedule 7.9(b)       | Litigation on Intellectual Properties  |
| Schedule 7.9(c)(iii)  | Exception to Seller's representation under Section 7.9(c)(iii)                                 |
| Schedule 7.9(c)(iv)   | Exception to Seller's representation under Section 7.9(c)(iv)                                  |
| Schedule 7.9(c)(v)    | Exception to Seller's representation under Section 7.9(c)(v)                                   |
| Schedule 7.9(c)(vi)   | Exception to Seller's representation under Section 7.9(c)(vi)                                  |
| Schedule 7.9(c)(xi)   | current and future payment for assignments of inventions or Intellectual Property Rights       |
| Schedule 7.11         | List of the Employees  |





| Subsidiary Name                                 | Jurisdiction           | Type          |
|---|------------------------|---------------|
| ART Advanced Recognition Technologies, Inc.     | Delaware               | Domestic      |
| Caere Corporation                               | Delaware               | Domestic      |
| Dictaphone Corporation                          | Delaware               | Domestic      |
| eCopy, LLC                                      | Delaware               | Domestic      |
| eScription, Inc.                                | Delaware               | Domestic      |
| Nuance Transcription Services, Inc. f/k/a Focus | Delaware               | Domestic      |
| Infomatics, Inc. f/k/a Focus Enterprises Ltd.   |                        |               |
| Keisense, Inc.                                  | Delaware               | Domestic      |
| Language and Computing Inc.                     | Delaware               | Domestic      |
| Locus Dialogue Technologies USA, Inc.           | Delaware               | Domestic      |
| MacSpeech LLC                                   | Delaware               | Domestic      |
| Medford Acquisition LLC                         | Delaware               | Domestic      |
| Nuance Communications International, Inc.       | Delaware               | Domestic      |
| Nuance Communications LLC                       | Delaware               | Domestic      |
| Nuance Services, Inc.                           | Delaware               | Domestic      |
| PerSay, Inc.                                    | Delaware               | Domestic      |
| Phonetic Systems Inc.                           | Delaware               | Domestic      |
| Rhetorical, Inc.                                | Delaware               | Domestic      |
| Ruetli Holding Corporation                      | Delaware               | Domestic      |
| SNAPin Software LLC                             | Delaware               | Domestic      |
| Sonic Acquisition Corporation                   | Delaware               | Domestic      |
| SpeechWorks International, Inc.                 | Delaware               | Domestic      |
| SpinVox Incorporated                            | Delaware               | Domestic      |
| Sutton Acquisition Corporation                  | Delaware               | Domestic      |
| SVOX U.S.A., Inc.                               | Delaware               | Domestic      |
| Viecore LLC                                     | Delaware               | Domestic      |
| Viecore Federal Systems Division, Inc.          | Delaware               | Domestic      |
| Voice Signal Technologies, Inc.                 | Delaware               | Domestic      |
| Webmedx, Inc.                                   | Delaware               | Domestic      |
| X-Solutions North America Inc.                  | Delaware               | Domestic      |
| Zi Holding Corporation                          | Delaware               | Domestic      |
| Equitrac Corporation                            | Florida                | Domestic      |
| ETRC Canada LLC                                 | Florida                | Domestic      |
| Zi Corporation of America, Inc.                 | Nevada                 | Domestic      |
| Medical Transcription Education Center          | Ohio                   | Domestic      |
| TransHealth, LLC                                | Tennessee              | Domestic      |
| Tegic Communications, Inc.                      | Washington             | Domestic      |
| Information Technologies Australia Pty Ltd.     | Australia              | International |
| ITA Services Pty Ltd.                           | Australia              | International |
| Nuance Communications Australia Pty. Ltd.       | Australia              | International |
| OTE Pty Limited                                 | Australia              | International |
| Nuance Communications Austria GmbH              | Austria                | International |
| SpeechMagic Holdings GmbH                       | Austria                | International |
| Multi-Corp International Ltd.                   | Barbados               | International |
| Language and Computing N.V.                     | Belgium                | International |
| Nuance Communications International BVBA        | Belgium                | International |
| Zi (Bermuda) Corporation                        | Bermuda                | International |
| Nuance Communications Ltda.                     | Brazil                 | International |
| BlueStar Options Inc.                           | British Virgin Islands | International |
| BlueStar Resources Limited                      | British Virgin Islands | International |
| SpeechWorks BVI Ltd.                            | British Virgin Islands | International |
| 1448451 Ontario Inc.                            | Canada                 | International |
| 845162 Alberta Ltd.                             | Canada                 | International |
| Equitrac Canada ULC                             | Canada                 | International |
| Nuance Acquisition ULC                          | Canada                 | International |
| Nuance Communications Canada, Inc.              | Canada                 | International |
| Zi Corporation                                  | Canada                 | International |
| Zi Corporation of Canada, Inc.                  | Canada                 | International |

| <b>Subsidiary Name</b>   | <b>Jurisdiction</b> | <b>Type</b>   |
|--|---------------------|---------------|
| Foxtrot Acquisition Limited  | Cayman Islands      | International |
| Foxtrot Acquisition II Limited   | Cayman Islands      | International |
| Huayu Zi Software Technology (Beijing) Co., Ltd.   | China               | International |
| Nuance Software Technology (Beijing) Co., Ltd.   | China               | International |
| Nuance Communications Finland OY   | Finland             | International |
| Voice Signal Technologies Europe OY  | Finland             | International |
| Nuance Communications France Sarl  | France              | International |
| Dictaphone Deutschland GmbH  | Germany             | International |
| Nuance Communications Aachen GmbH  | Germany             | International |
| Nuance Communications Germany GmbH   | Germany             | International |
| Nuance Communications Healthcare Germany GmbH  | Germany             | International |
| SVOX Deutschland GmbH  | Germany             | International |
| Asia Translation & Telecommunications Limited  | Hong Kong SAR       | International |
| Huayu Zi Software Technology Limited   | Hong Kong SAR       | International |
| Nuance Communications Hong Kong Limited  | Hong Kong SAR       | International |
| Telecom Technology Corporation Limited   | Hong Kong SAR       | International |
| Zi Corporation (H.K.) Limited  | Hong Kong SAR       | International |
| Zi Corporation of Hong Kong Limited  | Hong Kong SAR       | International |
| Nuance Recognita Corp.   | Hungary             | International |
| Nuance India Pvt. Ltd.   | India               | International |
| Nuance Transcription Services India Private Limited f/k/a/ FocusMT India Private Limited | India               | International |
| Nuance Communications International Holdings   | Ireland             | International |
| Nuance Communications Ireland Limited  | Ireland             | International |
| Nuance Communications Israel, Ltd.   | Israel              | International |
| PerSay Ltd.  | Israel              | International |
| Phonetic Systems Ltd.  | Israel              | International |
| Loquendo S.p.a.  | Italy               | International |
| Nuance Communications Italy Srl  | Italy               | International |
| Nuance Communications Japan K.K.   | Japan               | International |
| SVOX Japan K.K.  | Japan               | International |
| Voice Signal K.K.  | Japan               | International |
| Nuance Communications Netherlands B.V.   | Netherlands         | International |
| X-Solutions Group B.V.   | Netherlands         | International |
| Aangel Processing Limited  | New Zealand         | International |
| Casseggers Holdings Limited  | New Zealand         | International |
| Rhetorical Group plc.  | Scotland            | International |
| Rhetorical Systems Limited   | Scotland            | International |
| Nuance Communications Asia Pacific Pte. Ltd.   | Singapore           | International |
| Nuance Communications Iberica SA   | Spain               | International |
| Nuance Communications Korea Ltd.   | South Korea         | International |
| Nuance Communications Sweden, A.B.   | Sweden              | International |
| Nuance Communications Switzerland AG   | Switzerland         | International |
| SVOX AG  | Switzerland         | International |
| Zi Decuma AB   | Sweden              | International |
| Nuance Communications Taiwan   | Taiwan              | International |
| Nuance Communications Illetism Ltd. Sirketi  | Turkey              | International |
| Equitrac UK Limited  | United Kingdom      | International |
| Nuance Communications UK Limited   | United Kingdom      | International |
| SpinVox Limited  | United Kingdom      | International |
| SVOX Speech Solutions Ltd.   | United Kingdom      | International |

**Consent of Independent Registered Public Accounting Firm**

Nuance Communications, Inc.  
Burlington, Massachusetts

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (Nos. 333-142182, 333-100648, and 333-61862), and Form S-8 (Nos. 333-157579, 333-151088, 333-151087, 333-153911, 333-148684, 333-145971, 333-143465, 333-142183 333-141819, 333-134687, 333-128396, 333-124856, 333-122718, 333-108767, 333-99729, 333-75406, 333-49656, 333-33464, 333-30518 and 333-74343) of Nuance Communications, Inc. of our reports dated November 29, 2011 relating to the consolidated financial statements and the effectiveness of Nuance Communications, Inc.'s internal control over financial reporting, which appear in this Form 10-K.

/s/ BDO USA, LLP  
Boston, Massachusetts  
November 29, 2011

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
PURSUANT TO  
SECTION 302(A) OF THE SARBANES-OXLEY ACT OF 2002**

I, Paul A. Ricci, certify that:

1. I have reviewed this Annual Report on Form 10-K of Nuance Communications, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and in 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

By: /s/ Paul A. Ricci

Paul A. Ricci

Chief Executive Officer and Chairman of the Board

November 29, 2011

**CERTIFICATION OF CHIEF FINANCIAL OFFICER  
PURSUANT TO  
SECTION 302(A) OF THE SARBANES-OXLEY ACT OF 2002**

I, Thomas L. Beaudoin, certify that:

1. I have reviewed this Annual Report on Form 10-K of Nuance Communications, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and in 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

By: /s/ Thomas L. Beaudoin

Thomas L. Beaudoin

Executive Vice President and Chief Financial Officer

November 29, 2011

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER  
PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Paul A. Ricci, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Annual Report of Nuance Communications, Inc. on Form 10-K for the period ended September 30, 2011 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Annual Report on Form 10-K fairly presents in all material respects the financial condition and results of operations of Nuance Communications, Inc.

By: /s/ Paul A. Ricci  
Paul A. Ricci  
Chief Executive Officer and Chairman of the Board

November 29, 2011

I, Thomas L. Beaudoin, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Annual Report of Nuance Communications, Inc. on Form 10-K for the period ended September 30, 2011 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Annual Report on Form 10-K fairly presents in all material respects the financial condition and results of operations of Nuance Communications, Inc.

By: /s/ Thomas L. Beaudoin  
Thomas L. Beaudoin  
Executive Vice President and Chief Financial Officer

November 29, 2011

