Nuance Communications, Inc.
Form 10-Q
February 10, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2013
Or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 001-36056

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

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

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

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý 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 ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. 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	ý	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	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 ý
The number of shares of the Registrant's Common Stock, outstanding as of January 31, 2014 was 317,158,481.

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Part I. Financial Information

Item 1. Condensed Consolidated Financial Statements (unaudited)

NUANCE COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended December 31,	
	2013	2012
	(Unaudited)	
	(In thousands, except per share amounts)	
Revenues:		
Product and licensing	$178,437	$196,731
Professional services and hosting	218,135	200,305
Maintenance and support	73,408	65,232
Total revenues	469,980	462,268
Cost of revenues:		
Product and licensing	25,438	26,309
Professional services and hosting	154,580	125,156
Maintenance and support	12,608	14,797
Amortization of intangible assets	15,194	16,310
Total cost of revenues	207,820	182,572
Gross profit	262,160	279,696
Operating expenses:		
Research and development	80,470	68,721
Sales and marketing	118,906	117,135
General and administrative	44,476	44,784
Amortization of intangible assets	27,472	25,426
Acquisition-related costs, net	2,798	15,733
Restructuring and other charges, net	3,837	1,667
Total operating expenses	277,959	273,466
(Loss) income from operations	(15,799)	6,230
Other income (expense):		
Interest income	419	538
Interest expense	(33,959)	(34,117)
Other expense, net	(3,096)	(3,308)
Loss before income taxes	(52,435)	(30,657)
Provision (benefit) from income taxes	2,978	(8,561)
Net loss	$(55,413)	$(22,096)
Net loss per share:		
Basic	$(0.18)	$(0.07)
Diluted	$(0.18)	$(0.07)
Weighted average common shares outstanding:		
Basic	314,818	312,571
Diluted	314,818	312,571

See accompanying notes.

NUANCE COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

	Three Months Ended December 31,	
	2013	2012
	Unaudited (In thousands)	
Net loss	$(55,413)	$(22,096)
Other comprehensive income:		
Foreign currency translation adjustment	6,604	7,111
Recognition of pension loss amortization	—	133
Total other comprehensive income, net	6,604	7,244
Comprehensive loss	$(48,809)	$(14,852)

See accompanying notes.

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NUANCE COMMUNICATIONS, INC.
CONSOLIDATED BALANCE SHEETS

	December 31, 2013 (Unaudited)	September 30, 2013
	(In thousands, except per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$734,656	$808,118
Marketable securities	40,440	38,728
Accounts receivable, less allowances for doubtful accounts of $8,634 and $8,529	396,834	382,741
Prepaid expenses and other current assets	113,534	104,971
Deferred tax asset	75,211	74,969
Total current assets	1,360,675	1,409,527
Land, building and equipment, net	142,971	143,465
Goodwill	3,350,371	3,293,198
Intangible assets, net	954,309	953,278
Other assets	177,387	159,135
Total assets	$5,985,713	$5,958,603
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$248,518	$246,040
Accounts payable	59,120	91,016
Accrued expenses and other current liabilities	227,182	214,425
Deferred revenue	301,049	253,753
Total current liabilities	835,869	805,234
Long-term debt	2,112,759	2,108,091
Deferred revenue, net of current portion	183,205	160,823
Deferred tax liability	183,728	162,774
Other liabilities	61,532	83,667
Total liabilities	3,377,093	3,320,589
Commitments and contingencies (Notes 4 and 16)		
Stockholders' equity:		
Common stock, $0.001 par value; 560,000 shares authorized; 321,035 and 319,365 shares issued and 317,284 and 315,614 shares outstanding, respectively	321	319
Additional paid-in capital	3,044,837	3,017,074
Treasury stock, at cost (3,751 shares)	(16,788)	(16,788)
Accumulated other comprehensive income	13,417	6,813
Accumulated deficit	(433,167)	(369,404)
Total stockholders' equity	2,608,620	2,638,014
Total liabilities and stockholders' equity	$5,985,713	$5,958,603

See accompanying notes.

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NUANCE COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended December 31,	
	2013	2012
	(Unaudited)	
	(In thousands)	
Cash flows from operating activities:		
Net loss	$(55,413)	$(22,096)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	55,109	50,429
Stock-based compensation	47,239	45,271
Non-cash interest expense	9,661	9,986
Deferred tax benefit	(1,612)	(4,077)
Other	(6,150)	(1,925)
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	(6,532)	8,815
Prepaid expenses and other assets	(11,095)	(9,104)
Accounts payable	(28,032)	(18,692)
Accrued expenses and other liabilities	7,452	9,241
Deferred revenue	67,529	55,100
Net cash provided by operating activities	78,156	122,948
Cash flows from investing activities:		
Capital expenditures	(14,166)	(15,104)
Payments for business and technology acquisitions, net of cash acquired	(99,496)	(446,192)
Purchases of marketable securities and other investments	(5,063)	—
Proceeds from sales and maturities of marketable securities and other investments	13,372	456
Net cash used in investing activities	(105,353)	(460,840)
Cash flows from financing activities:		
Payments of debt	(1,307)	(144,835)
Proceeds from long-term debt, net of issuance costs	—	352,611
Payments for repurchase of common stock	(18,000)	—
Payments for settlement of share-based derivatives	(1,032)	(177)
Payments of other long-term liabilities	(904)	(1,012)
Excess tax benefits on employee equity awards	—	4,974
Proceeds from issuance of common stock from employee stock plans	1,188	1,906
Cash used to net share settle employee equity awards	(26,506)	(43,859)
Net cash (used in) provided by financing activities	(46,561)	169,608
Effects of exchange rate changes on cash and cash equivalents	296	(389)
Net decrease in cash and cash equivalents	(73,462)	(168,673)
Cash and cash equivalents at beginning of period	808,118	1,129,761
Cash and cash equivalents at end of period	$734,656	$961,088

See accompanying notes.

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NUANCE COMMUNICATIONS, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Presentation

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

We reclassified certain immaterial amounts between product and licensing and maintenance and support revenues previously reported for the three months ended December 31, 2012. The reclassifications have no impact on earnings or cash flows provided by operations.

Although we believe the disclosures in these financial statements are adequate to make the information presented not misleading, certain information normally included in the footnotes prepared in accordance with GAAP has been omitted. Accordingly, these financial statements should be read in conjunction with the audited financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2013. Interim results are not necessarily indicative of the results that may be expected for a full year.

2. Summary of Significant Accounting Policies

Effective October 1, 2013, we implemented Accounting Standards Update No. 2013-02, Comprehensive Income (Topic 220) — Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, which did not have a significant impact on our consolidated financial statements.

We have made no material changes to the significant accounting policies disclosed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2013.

Recently Issued Accounting Standards

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" (ASU 2013-11) to provide guidance on the presentation of unrecognized tax benefits. ASU 2013-11 requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows: to the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. ASU 2013-11 is effective for us in our first quarter of fiscal 2015 with earlier adoption permitted. ASU 2013-11 should be applied prospectively with retroactive application permitted. We do not believe that this will have a material impact on our consolidated financial statements.

3. Business Acquisitions

Fiscal 2014 Acquisitions

During fiscal 2014, we acquired several businesses for total cash consideration of $101.0 million. In allocating the total purchase consideration for these acquisitions based on preliminary estimated fair values, we recorded $51.9 million of goodwill and $42.5 million of identifiable intangibles assets. Intangible assets acquired included customer relationships and core and completed technology with weighted average useful lives of 10.0 years. These acquisitions are not individually material and were made in our Healthcare and Enterprise segments. These acquisitions are treated as stock purchases, and the goodwill resulting from these acquisitions is not expected to be deductible for tax purposes.

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

Pro Forma Results

On May 31, 2013, we acquired the Technology Solutions Segment ("TGT") of the Tweddle Group for total consideration of $83.3 million in cash, including a purchase price adjustment as specified in the asset purchase agreement. TGT provides cloud-based infotainment and communications solutions to the automotive industry. The transaction was structured as an asset acquisition, and therefore the goodwill is expected to be deductible for tax purposes. The results of operations for TGT are included in our Mobile and Consumer segment from the acquisition date.

The following table shows unaudited pro forma results of operations as if we had acquired TGT on October 1, 2012 (dollars in thousands, except per share amounts):

	Three Months Ended December 31,	
	2013	2012
Revenue	$469,980	$464,364
Net loss	(55,413)	(25,669)
Net loss per share - diluted	$(0.18)	$(0.08)

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

Acquisition-Related Costs, net

Acquisition-related costs include costs related to business and other acquisitions, including potential acquisitions. These costs consist of (i) transition and integration costs, including retention payments, transitional employee costs and earn-out payments treated as compensation expense, as well as the costs of integration-related activities including services provided by third-parties; (ii) professional service fees, including third party costs related to the acquisitions, and 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.

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

	Three Months Ended December 31,	
	2013	2012
Transition and integration costs	$3,839	$6,263
Professional service fees	3,339	9,470
Acquisition-related adjustments	(4,380)	—
Total	$2,798	$15,733

Included in acquisition-related adjustments for the three months ended December 31, 2013, is income of $7.7 million related to the elimination of a contingent liability established in the original allocation of purchase price for an acquisition closed in fiscal 2008, following the expiration of the applicable statute of limitations. As a result, we have eliminated the contingent liability, and included the adjustment in acquisition-related costs, net in our consolidated statements of operations.

4. Contingent Acquisition Payments

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 included in acquisition-related costs, net in each reporting period.

In connection with our acquisition of JA Thomas in October 2012, we agreed to make deferred payments to the former shareholders of JA Thomas of up to $25.0 million in October 2014, contingent upon the continued employment of certain named executives and certain other conditions. The contingent payments will be reduced by amounts specified in the merger agreement in the event that any of the named executives terminates their employment prior to the payment date. The portion of the deferred

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

payment that is payable to the named executives is being recognized as compensation expense over the two year employment period and included in acquisition-related costs, net in our consolidated statement of operations.

5. Goodwill and Intangible Assets

The changes in the carrying amount of goodwill and intangible assets for the three months ended December 31, 2013, are as follows (dollars in thousands):

	Goodwill	Intangible Assets
Balance at September 30, 2013	$3,293,198	$953,278
Acquisitions	51,871	43,409
Purchase accounting adjustments	542	(59)
Amortization	—	(42,666)
Effect of foreign currency translation	4,760	347
Balance at December 31, 2013	$3,350,371	$954,309

6. Financial Instruments and Hedging Activities

Derivatives Not Designated as Hedges

Forward Currency Contracts

We operate our business in countries throughout the world and transact business in various foreign currencies. Our foreign currency exposures typically arise from transactions denominated in currencies other than the functional currency of our operations. We have a program that primarily utilizes foreign currency forward contracts to offset the risks associated with the effect of certain foreign currency exposures. Our program is designed so that increases or decreases in our foreign currency exposures are offset by gains or losses on the foreign currency forward contracts in order to mitigate the risks and volatility associated with our foreign currency transactions. Generally we enter into contracts for less than 90 days, and at December 31, 2013 and September 30, 2013, we had outstanding contracts with a total notional value of $330.8 million and $247.8 million, respectively.

We have not designated these forward contracts as hedging instruments pursuant to ASC 815, Derivatives and Hedging, and accordingly, we record the fair value of these contracts at the end of each reporting period in our consolidated balance sheet, with changes in the fair value recorded in earnings as other expense, net in our consolidated statements of operations.

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 expense, net in our consolidated statements of operations.

The following is a summary of the outstanding shares subject to security price guarantees at December 31, 2013 (dollars in thousands):

Issue Date	Number of Shares Issued	Settlement Date	Total Value of Shares on Issue Date
August 15, 2013	934,960	February 15, 2014	$ 18,400

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

The following table provides a quantitative summary of the fair value of our derivative instruments as of December 31, 2013 and September 30, 2013 (dollars in thousands):

Derivatives Not Designated as Hedges:	Balance Sheet Classification	Fair Value	
		December 31, 2013	September 30, 2013
Foreign currency contracts	Prepaid expenses and other current assets	$949	$2,201
Security Price Guarantees	Accrued expenses and other current liabilities	(4,182)	(1,044)
Net fair value of non-hedge derivative instruments		$(3,233)	$1,157

The following tables summarize the activity of derivative instruments for the three months ended December 31, 2013 and 2012 (dollars in thousands):

		Amount of Gain (Loss) Recognized in Income	
Derivatives Not Designated as Hedges	Location of Gain (Loss) Recognized in Income	2013	2012
Foreign currency contracts	Other expense, net	$1,963	$(104)
Security price guarantees	Other expense, net	$(4,150)	$(2,510)

Other Financial Instruments

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

The estimated fair value of our long-term debt approximated $2,431.5 million (face value $2,471.0 million) and $2,458.2 million (face value $2,472.2 million) at December 31, 2013 and September 30, 2013, 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 Senior Notes, the term loan portion of our Credit Facility, and the Convertible Debentures are traded and the fair values are based upon trading prices as of the reporting dates. The fair values of each borrowing was estimated using the averages of the bid and ask trading quotes at each respective date. We had no outstanding balance on the revolving credit line portion of our Credit Facility at December 31, 2013 and September 30, 2013.

7.Fair Value Measures

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

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

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

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

Items measured at Fair Value on a Recurring Basis
Assets and liabilities measured at fair value on a recurring basis at December 31, 2013 and September 30, 2013 consisted of (dollars in thousands):

	December 31, 2013			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds(a)	$617,061	$—	$—	$617,061
US government agency securities(a)	1,000	—	—	1,000
Marketable securities, $40,440 at cost (b)	—	40,440	—	40,440
Foreign currency exchange contracts(b)	—	949	—	949
Total assets at fair value	$618,061	$41,389	$—	$659,450
Liabilities:				
Security price guarantees(c)	$—	$(4,182)	$—	$(4,182)
Contingent earn-out(d)	—	—	(1,319)	(1,319)
Total liabilities at fair value	$—	$(4,182)	$(1,319)	$(5,501)

	September 30, 2013			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds(a)	$684,697	$—	$—	$684,697
US government agency securities(a)	1,000	—	—	1,000
Marketable securities, $38,728 at cost (b)	—	38,728	—	38,728
Foreign currency exchange contracts(b)	—	2,201	—	2,201
Total assets at fair value	$685,697	$40,929	$—	$726,626
Liabilities:				
Security price guarantees(c)	$—	$(1,044)	$—	$(1,044)
Contingent earn-out(d)	—	—	(450)	(450)
Total liabilities at fair value	$—	$(1,044)	$(450)	$(1,494)

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

(b) The fair values of our time deposits, marketable securities and foreign currency exchange contracts are 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 U.S. 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 arrangements are determined based on our evaluation as to the probability and amount of any earn-out that will be achieved based on expected future performance by the acquired entity.

The changes in the fair value of contingent earn-out liabilities are as follows (dollars in thousands):

	Three Months Ended December 31, 2013
Balance at beginning of period	$450

Earn-out liability established at time of acquisition	869
Balance at end of period	$1,319

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

Earn-out payments are payable based on achieving the specified performance criteria during defined post-acquisition time periods in accordance with the purchase and sale agreement for each acquisition.

8. Accrued Expenses and Other Current Liabilities

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

	December 31, 2013	September 30, 2013
Compensation	$91,875	$112,756
Acquisition costs and liabilities	31,546	15,722
Accrued interest payable	27,005	15,879
Cost of revenue related liabilities	18,600	17,992
Professional fees	15,881	17,682
Sales and marketing incentives	12,803	11,681
Sales and other taxes payable	11,980	10,625
Other	17,492	12,088
Total	$227,182	$214,425

9. Deferred Revenue

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

	December 31, 2013	September 30, 2013
Current Liabilities:		
Deferred maintenance revenue	$136,552	$134,213
Unearned revenue	164,497	119,540
Total current deferred revenue	$301,049	$253,753
Long-term Liabilities:		
Deferred maintenance revenue	$58,312	$51,784
Unearned revenue	124,893	109,039
Total long-term deferred revenue	$183,205	$160,823

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

The increase in unearned revenue is primarily driven by the timing of a large annual prepayment from a Healthcare customer that will be amortized over the one year service period, as well as an increase in Mobile deferred revenue related to growth in our automotive connected services for which the revenue recognition period extends over the service period.

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

10. Restructuring and Other Charges, net

Restructuring and other charges, net include restructuring expenses together with other expenses that are unusual in nature and are the result of unplanned events, and arise outside of the ordinary course of continuing operations. Restructuring expenses consist of employee severance costs and may also include charges for duplicate facilities and other contract termination costs. Other amounts may include gains or losses on non-controlling strategic equity interests, and gains or losses on sales of non-strategic assets or product lines. The following table sets forth accrual activity relating to our restructuring reserves for the three months ended December 31, 2013 (dollars in thousands):

	Personnel	Facilities	Total
Balance at September 30, 2013	$4,230	$1,191	$5,421
Restructuring charges, net	1,419	2,418	3,837
Non-cash adjustments	80	761	841
Cash payments	(3,261)	(607)	(3,868)
Balance at December 31, 2013	$2,468	$3,763	$6,231

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

	Three Months Ended December 31,					
	2013			2012		
	Personnel	Facilities	Total	Personnel	Facilities	Total
Healthcare	$214	$—	$214	$653	$558	$1,211
Mobile and Consumer	202	—	202	1,099	—	1,099
Enterprise	177	—	177	—	—	—
Imaging	—	—	—	822	—	822
Corporate	826	2,418	3,244	143	—	143
Total restructuring expense	$1,419	$2,418	$3,837	$2,717	$558	$3,275

For the three months ended December 31, 2013, we recorded net restructuring charges of $3.8 million, which included a $1.4 million severance charge related to the elimination of approximately 20 personnel across multiple functions, and $2.4 million resulting from the restructuring of a facility that will no longer be utilized.

11. Debt and Credit Facilities

At December 31, 2013 and September 30, 2013, we had the following borrowing obligations (dollars in thousands):

	December 31, 2013	September 30, 2013
5.375% Senior Notes due 2020, net of unamortized premium of $5.2 million and $5.4 million, respectively. Effective interest rate 5.28%.	$1,055,190	$1,055,385
2.75% Convertible Debentures due 2031, net of unamortized discount of $107.5 million and $113.5 million, respectively. Effective interest rate 7.43%.	582,529	576,524
2.75% Convertible Debentures due 2027, net of unamortized discount of $6.3 million and $8.8 million, respectively. Effective interest rate 7.30%.	243,683	241,206
Credit Facility, net of unamortized discount of $1.1 million and $1.2 million, respectively.	479,875	481,016
Total long-term debt	$2,361,277	$2,354,131
Less: current portion	248,518	246,040
Non-current portion of long-term debt	$2,112,759	$2,108,091

2.75% Convertible Debentures due 2031

As of December 31, 2013 and September 30, 2013, none of the conversion criteria were met for the 2031 Debentures. If the conversion criteria were met, we could be required to repay all or some of the principal amount in cash prior to maturity.

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

2.75% Convertible Debentures due 2027

The 2027 Debentures are puttable at the holders option in August 2014. As a result, we have classified the obligation in current liabilities at December 31, 2013 and September 30, 2013.

Credit Facility

The Credit Facility includes a term loan and a $75 million revolving credit line, including letters of credit. The term loan matures on August 7, 2019 and the revolving credit line matures on August 7, 2018. As of December 31, 2013, there were $7.2 million of letters of credit issued, and there were no other outstanding borrowings under the revolving credit line.

Under terms of the amended and restated 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 corporate base rate of Morgan Stanley, the Administrative Agent, 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 at December 31, 2013 is as follows:

Description	Base Rate Margin	LIBOR Margin
Term loans maturing August 2019	1.75%	2.75%
Revolving facility due August 2018	0.50% - 0.75% (a)	1.50% - 1.75% (a)

(a) The margin is determined based on our net leverage ratio at the date the interest rates are reset on the revolving credit line.

At December 31, 2013 the applicable margin for the term loans was 2.75%, with an effective rate of 2.92%, on the outstanding balance of $481.0 million maturing in August 2019. 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 net leverage ratio. As of December 31, 2013, the commitment fee rate was 0.375%.

The Credit Facility contains the most restrictive covenants of our long-term debt, including, among other things, covenants that restrict our ability and those of our subsidiaries to incur certain additional indebtedness or issue guarantees, 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, or merge or consolidate with any entity, and limits transactions with affiliates. 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 December 31, 2013, we were in compliance with the covenants under the Credit Facility. The covenants on our other long-term debt are less restrictive, and we have met these requirements.

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 Credit Facility includes a provision for an annual excess cash flow sweep, as defined in the agreement, payable in the first quarter of each fiscal year, based on the excess cash flow generated in the previous fiscal year. No excess cash flow sweep was required in the first quarter of fiscal 2014 as no excess cash flow, as defined in the agreement was generated in fiscal 2013. At the current time, we are unable to predict the amount of the outstanding principal, if any,

that we may be required to repay in future fiscal years pursuant to the excess cash flow sweep provisions.

12. Stockholders' Equity

Stock Repurchases

On April 29, 2013, our Board of Directors approved a share repurchase program for up to $500 million of our outstanding shares of common stock. Approximately $295.9 million remained available for stock repurchases as of December 31, 2013 pursuant

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

to our stock repurchase program. We repurchased 1.2 million shares for $19.7 million during the three months ended December 31, 2013 (including 0.1 million shares for $1.7 million that were repurchased, but not settled at December 31, 2013). Under the terms of the repurchase program, we expect to continue to repurchase shares from time to time through a variety of methods, which may include open market purchases, privately negotiated transactions, block trades, accelerated stock repurchase transactions, or any combination of such methods. The timing and the amount of any purchases will be determined by management based on an evaluation of market conditions, capital allocation alternatives, and other factors. The share repurchase program does not require us to acquire any specific number of shares and may be modified, suspended, extended or terminated by us at any time without prior notice.

13. Net Loss Per Share

Common equivalent shares are excluded from the computation of diluted net loss per share if their effect is anti-dilutive. Potentially dilutive common equivalent shares aggregating to 13.7 million and 14.8 million shares for the three months ended December 31, 2013 and 2012, respectively, have been excluded from the computation of diluted net loss per share because their inclusion would be anti-dilutive.

14. Stock-Based Compensation

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

	Three Months Ended December 31,	
	2013	2012
Cost of product and licensing	$265	$185
Cost of professional services and hosting	6,619	2,403
Cost of maintenance and support	784	2,103
Research and development	10,288	8,860
Selling and marketing	15,244	16,847
General and administrative	14,039	14,873
Total	$47,239	$45,271

Stock Options

The table below summarizes activity relating to stock options for the three months ended December 31, 2013:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value(a)	
Outstanding at September 30, 2013	4,184,158	$13.08			
Exercised	(140,260)	$8.47			
Forfeited	(974)	$20.04			
Expired	(2,393)	$17.46			
Outstanding at December 31, 2013	4,040,531	$13.23	2.7 years	$9.8	million
Exercisable at December 31, 2013	4,019,980	$13.23	2.7 years	$9.7	million
Exercisable at December 31, 2012	5,715,146	$11.54	2.9 years	$61.6	million

(a)

The aggregate intrinsic value in this table was calculated based on the positive difference, if any, between the closing market value of our common stock on December 31, 2013 ($15.20) and the exercise price of the underlying options.

The weighted-average intrinsic value of stock options exercised during the three months ended December 31, 2013 and 2012 was $1.2 million and $5.2 million, respectively.

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

Restricted Units

Restricted Units are not included in issued and outstanding common stock until the shares are vested and released. The purchase price for vested Restricted Units is $0.001 per share. The table below summarizes activity relating to Restricted Units for the three months ended December 31, 2013:

	Number of Shares Underlying Restricted Units — Contingent Awards	Number of Shares Underlying Restricted Units — Time-Based Awards
Outstanding at September 30, 2013	5,587,181	9,095,424
Granted	1,404,938	3,605,109
Earned/released	(745,689)	(3,242,497)
Forfeited	(1,289,490)	(195,182)
Outstanding at December 31, 2013	4,956,940	9,262,854
Weighted average remaining recognition period of outstanding Restricted Units	2.0 years	1.9 years
Unearned stock-based compensation expense of outstanding Restricted Units	$75.1 million	$131.2 million
Aggregate intrinsic value of outstanding Restricted Units(a)	$75.3 million	$140.9 million

(a) The aggregate intrinsic value in this table was calculated based on the positive difference between the closing market value of our common stock on December 31, 2013 ($15.20) and the purchase price of the underlying Restricted Units.

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

	Three Months Ended December 31,	
	2013	2012
Weighted-average grant-date fair value per share	$14.59	$22.25
Total intrinsic value of shares vested (in millions)	$59.0	$100.9

Restricted Stock Awards

Restricted Stock Awards are included in the issued and outstanding common stock at the date of grant. The table below summarizes activity related to Restricted Stock Awards for the three months ended December 31, 2013:

	Number of Shares Underlying Restricted Stock	Weighted Average Grant Date Fair Value
Outstanding at September 30, 2013	1,000,000	$24.06
Granted	250,000	$15.71
Vested	(250,000)	$25.80
Forfeited	—	$—
Outstanding at December 31, 2013	1,000,000	$21.54
Weighted average remaining recognition period of outstanding Restricted Awards	1.6 years	
Unearned stock-based compensation expense of outstanding Restricted Awards	$19.7 million	
Aggregate intrinsic value of outstanding Restricted Awards	$15.2 million	

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

	Three Months Ended December 31,

	2013	2012
Weighted-average grant-date fair value per share	$15.71	$22.32
Total intrinsic value of shares vested (in millions)	$3.9	$5.3

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

15. Income Taxes

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

	Three Months Ended December 31,	
	2013	2012
Domestic	$(1,455)	$(16,488)
Foreign	4,433	7,927
Provision (benefit) from income taxes	$2,978	$(8,561)
Effective tax rate	(5.7)%	27.9%

The effective income tax rate was (5.7)% and 27.9% for the three months ended December 31, 2013 and 2012, respectively. Our current effective tax rate differs from the U.S. federal statutory rate of 35% primarily due to earnings in foreign operations which are subject to a significantly lower tax rate than the U.S. statutory tax rate driven primarily by our subsidiaries in Ireland. The effective tax rate for the three months ended December 31, 2013 was also impacted by a $5.2 million benefit for income taxes due to the release of a portion of the domestic valuation allowance resulting from a one-time tax benefit recorded in connection with an immaterial acquisition for which a net deferred tax liability was established related to acquired intangible assets.

Our effective income tax rate is based upon the income for the year, the composition of income in different countries, changes relating to valuation allowances for certain countries if and as necessary, and adjustments, if any, for the potential tax consequences, benefits or resolutions of audits or other tax contingencies. Our aggregate income tax rate in foreign jurisdictions is lower than our income tax rate in the United States. Our effective tax rate may be adversely affected by earnings being lower than anticipated in countries where we have lower statutory tax rates and higher than anticipated in countries where we have higher statutory tax rates. For the three months ended December 31, 2013, our international profits are lower as compared to the three months ended December 31, 2012, and therefore, the impact on our effective tax rate from our foreign operations is lower in the first quarter of fiscal 2014 as compared to prior year.

At December 31, 2013 and September 30, 2013, the liability for income taxes associated with uncertain tax positions was $20.1 million and $19.6 million, respectively, and is included in other long-term liabilities. If these benefits were recognized, they would favorably impact the effective tax rate. We do not expect a significant change in the amount of unrecognized tax benefits within the next twelve months.

16. Commitments and Contingencies

Litigation and Other Claims

Like many companies in the software industry, we have, from time to time, been notified of claims that we may be infringing on, 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 resolution of any such claim or litigation will have a material adverse effect on our financial position and results of operations. However, resolution of any such claim or litigation could require significant management time and adversely impact our operating results, financial position and cash flows.

Guarantees and Other

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

some cases our total liability under such provisions is unlimited. In many, but not all cases, the term of the indemnity provision is perpetual. While the maximum potential amount of future payments we could be required to make under all the indemnification provisions is unlimited, we believe the estimated fair value of these provisions is minimal due to the low frequency with which these provisions have been triggered.

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

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.

17. Segment and Geographic Information and Significant Customers

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

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

	Three months ended December 31,	
	2013	2012
Segment revenues(a):		
Healthcare	$227,286	$217,374
Mobile and Consumer	115,262	131,731
Enterprise	89,202	83,696
Imaging	58,295	59,616
Total segment revenues	490,045	492,417
Acquisition-related revenues	(20,065)	(30,149)
Total consolidated revenues	469,980	462,268
Segment profit:		
Healthcare	78,460	89,135
Mobile and Consumer	13,442	39,826
Enterprise	21,134	21,669
Imaging	22,680	23,060
Total segment profit	135,716	173,690
Corporate expenses and other, net	(31,206)	(30,137)
Acquisition-related revenues and cost of revenues adjustment	(18,832)	(27,666)
Stock-based compensation	(47,239)	(45,271)
Amortization of intangible assets	(42,666)	(41,736)
Acquisition-related costs, net	(2,798)	(15,733)
Restructuring and other charges, net	(3,837)	(1,667)
Costs associated with IP collaboration agreements	(4,937)	(5,250)
Other expense, net	(36,636)	(36,887)

Loss before income taxes	$(52,435)	$(30,657)

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

(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.

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):

	Three months ended December 31,	
	2013	2012
United States	$343,185	$340,288
International	126,795	121,980
Total revenues	$469,980	$462,268

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

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

CAUTIONARY NOTE CONCERNING FORWARD-LOOKING STATEMENTS

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

- our future bookings, revenues, cost of revenues, research and development expenses, selling, general and administrative expenses, amortization of intangible assets and gross margin;
- our strategy relating to our segments;
- 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 o comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks described in Item 1A — "Risk Factors" and elsewhere in this Quarterly Report on Form 10-Q.

You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

OVERVIEW

Business Overview

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

- Healthcare. Trends in our healthcare business include continuing customer preference for hosted solutions and other time-based licenses, and increasing interest in the use of mobile devices to access healthcare systems and records. We continue to see strong demand for transactions which involve the sale and delivery of both software and non-software related services or products, as well as transactions which involve the sale of multiple solutions, such as both hosted transcription services and Dragon Medical licenses. Although the volume processed in our hosted transcription services has steadily increased due to the expanding customer base, we have experienced some erosion in lines processed when customers adopt electronic medical record (EMR) systems, and when in some cases customers use

our licensed Dragon Medical product to support input into the EMR. We believe an important trend in the healthcare market is the impending change in the coding standard from ICD-9 to ICD-10 which is scheduled to take effect in October 2014. Customers are adopting our solutions under the current coding standard, and we believe the migration to ICD-10 is creating an imperative

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to increase automation of this important workflow. We are investing to expand our product set to address the various healthcare opportunities, including deeper integration with our clinical documentation solutions, as well as expand our international capabilities, and reduce our time from contract signing to initiation of billable services.

- Mobile and Consumer. Trends in our mobile and consumer segment include device manufacturers requiring custom applications to deliver unique and differentiated products such as virtual assistants, 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, tablet computers, cameras and third-party applications. The more powerful capabilities of mobile devices require us to supply a broader set of technologies to support the increasing scope and complexity of the solutions. These technologies include cloud-based speech recognition, natural language understanding, dialog management, text-to-speech and enhanced text input, where the complexity of the technologies allow us to charge a higher price. Within given levels of our technology set, we have seen pricing pressures from our OEM partners in our mobile handset business. We continue to see strong demand for transactions which involve the sale and delivery of both software and non-software related services, as well as products to help customers define, design and implement increasingly robust and complex custom solutions such as virtual assistants. We continue to see an increasing proportion of revenue from on-demand and transactional arrangements as opposed to traditional upfront licensing of our mobile products and solutions. Although this has a negative impact on near-term revenue, we believe this model will build stronger and more predictable revenues over time. 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. Trends in our enterprise business include increasing interest in the use of mobile applications and web sites to access customer care systems and records, voice-based authentication of users, increasing interest in coordinating actions and data across customer care channels, and the ability of a broader set of hardware providers and systems integrators to serve the market. 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. The imaging market is evolving to include more networked solutions, mobile access to networked solutions, and multi-function devices. We expect to expand our traditional packaged software sales with subscription versions. We are investing to improve mobile access to our networked products, expand our distribution channels and embedding relationships, and expand our language coverage.

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 2014, 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 have increased our focus on operating efficiencies, expense and hiring 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 our broad portfolio of technologies, applications and intellectual property to foster technological innovation and to maintain customer preference for our solutions. We also intend to invest further in our engineering resources and to seek new technological advancements that further expand the addressable markets for our solutions.

- Broaden Expertise in Vertical Markets. Businesses are increasingly turning to us for comprehensive solutions rather than for a single technology product. We intend to broaden our expertise and capabilities to continue 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.

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- Increase Subscription and Transaction Based Recurring Revenue. We intend to increase our subscription and transaction based offerings in all of our segments. This will enable us to deliver applications that our customers use, and pay for, on a repeat 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 established markets such as Europe, and also emerging markets within Asia and Latin America. We continue to add regional executives and sales employees across 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, and to complement our organic growth. We have proven experience in integrating businesses and technologies to deliver 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. We have, however, recently slowed the pace and reduced the size of acquisitions to focus our resources more on driving organic growth. We also have 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.

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 three months ended December 31, 2013, as compared to the three months ended December 31, 2012, is as follows:

- Total revenue increased by $7.7 million to $470.0 million;
- Net loss increased by $33.3 million to a loss of $55.4 million;
- Gross margins decreased by 4.7 percentage points to 55.8%;
- Operating margins decreased by 4.7 percentage points to (3.4)%; and
- Cash provided by operating activities decreased by $44.7 million to $78.2 million.

In addition to the above key financial metrics, we also focus on certain operating metrics. A summary of these key operating metrics as of December 31, 2013, as compared to December 31, 2012, is as follows:

- Annualized line run-rate in our on-demand healthcare solutions declined 1% from one year ago to approximately 5.1 billion lines per year. The annualized line run-rate is determined using billed equivalent line counts in a given quarter, multiplied by four;
- Bookings increased 26.2% from one year ago to $637.3 million. Bookings represent the estimated gross revenue value of transactions at the time of contract execution, except for maintenance and support offerings. For fixed price contracts, the bookings value represents the gross total contract value. For contracts where revenue is based on transaction volume, the bookings value represents the contract price multiplied by the estimated future transaction volume during the contract term, whether or not such transaction volumes are guaranteed under a minimum commitment clause. Actual results could be different than our initial estimate. The maintenance and support, bookings value represent the amounts billed in the period the customer is invoiced. Because of the inherent estimates required to determine bookings and the fact that the actual resultant revenue may differ from our initial bookings estimates, we consider bookings one indicator of potential future revenue and not as an arithmetic measure of backlog; and
- Estimated three-year value of on-demand contracts increased 7% from one year ago to approximately $2.2 billion. We determine this value as of the end of the period reported, by using our best estimate of three years of anticipated future revenue streams under signed on-demand contracts then in place, whether or not they are guaranteed through a minimum commitment clause. Our best estimate is based on estimates used in evaluating the contracts and determining sales compensation, adjusted for changes in estimated launch dates, actual volumes achieved and other factors deemed relevant. For contracts with an expiration date beyond three years, we include only the value expected within three years. For other contracts, we assume renewal consistent with historic renewal rates unless there is a known cancellation. Contracts are generally priced by volume of usage and typically have no or low minimum commitments. Actual revenue could vary from our estimates due to factors such as cancellations, non-renewals or volume fluctuations.

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RESULTS OF OPERATIONS

Total Revenues

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

	Three Months Ended December 31,		Dollar Change	Percent Change
	2013	2012		
Product and licensing	$178.5	$196.8	$(18.3)	(9.3)%
Professional services and hosting	218.1	200.3	17.8	8.9 %
Maintenance and support	73.4	65.2	8.2	12.6 %
Total Revenues	$470.0	$462.3	$7.7	1.7 %
United States	$343.2	$340.3	$2.9	0.9 %
International	126.8	122.0	4.8	3.9 %
Total Revenues	$470.0	$462.3	$7.7	1.7 %

The geographic split for the three months ended December 31, 2013, was 73% of total revenues in the United States and 27% internationally, compared to 74% of total revenues in the United States and 26% internationally for the same period last year.

Product and Licensing Revenue

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

	Three Months Ended December 31,		Dollar Change	Percent Change
	2013	2012		
Product and licensing revenue	$178.5	$196.8	$(18.3)	(9.3)%
As a percentage of total revenue	38.0 %	42.6 %		

The decrease in product and licensing revenue for the three months ended December 31, 2013, as compared to the three months ended December 31, 2012, consisted of a $19.1 million decrease in Mobile and Consumer revenue driven primarily by a $10.4 million decrease in sales of our Dragon desktop consumer products following the successful new product launch in the fall of 2012 and an overall weakness in desktop software sales. Sales of our embedded licenses in our Mobile and Consumer segment also decreased $8.6 million resulting from a continuing shift toward on-demand and ratable pricing models. Enterprise revenue decreased $9.4 million driven primarily by lower sales of our on-premise solutions. These decreases were offset by an $8.0 million increase in our Healthcare revenue driven primarily by sales of our Clintegrity solutions.

As a percentage of total revenue, product and licensing revenue decreased from 42.6% to 38.0% for the three months ended December 31, 2013. This decrease was driven by lower sales of embedded licenses in our Mobile and Consumer segment, resulting from a continuing shift toward on-demand and hosting services. Within product and licensing revenue, we are also seeing more term-based, subscription and transactional pricing models, which are recognized over time. In addition, the decrease includes the impact of our recent acquisitions, which have a higher proportion of on-demand hosting revenue. We expect this trend to continue through the remainder of fiscal 2014.

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 infotainment, search and transcription, over a specified term. The following table shows professional services and hosting revenue, in dollars and as a percentage of total revenues (dollars in millions):

	Three Months Ended December 31,		Dollar Change	Percent Change
	2013	2012		

Professional services and hosting revenue	$218.1	$200.3	$17.8	8.9%
As a percentage of total revenue	46.4 %	43.3 %		

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The increase in professional services and hosting revenue for the three months ended December 31, 2013, as compared to the three months ended December 31, 2012, consisted of a $9.8 million increase in our Enterprise revenue and a $6.3 million increase in our Healthcare revenue primarily driven by our recent acquisitions.

As a percentage of total revenue, professional services and hosting revenue increased from 43.3% to 46.4% for the three months ended December 31, 2013. This increase was driven by our recent Healthcare and Enterprise acquisitions, which have a higher proportion of professional services and hosting revenue. The increase also includes the continuing shift toward on-demand and ratable pricing models in our Mobile and Consumer segment. We expect this revenue mix shift to continue through the remainder of fiscal 2014.

Maintenance and Support Revenue

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

	Three Months Ended December 31,		Dollar Change	Percent Change
	2013	2012		
Maintenance and support revenue	$73.4	$65.2	$8.2	12.6%
As a percentage of total revenue	15.6 %	14.1 %		

The increase in maintenance and support revenue for the three months ended December 31, 2013, as compared to the three months ended December 31, 2012, included a $2.6 million increase in Healthcare revenue driven by sales of our Dragon Medical solutions together with an increase of $2.5 million in Enterprise revenue driven by strong maintenance renewals and license bookings in prior periods.

Costs and Expenses

Cost of Product and Licensing Revenue

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

	Three Months Ended December 31,		Dollar Change	Percent Change
	2013	2012		
Cost of product and licensing revenue	$25.4	$26.3	$(0.9)	(3.4)%
As a percentage of product and licensing revenue	14.2 %	13.4 %		

The decrease in cost of product and licensing revenue for the three months ended December 31, 2013, as compared to the three months ended December 31, 2012, consisted of a $2.2 million decrease in Mobile and Consumer costs primarily driven by lower sales of our Dragon desktop consumer products offset by a $1.4 million increase in Healthcare segment costs, primarily from higher sales of our Clintegrity solutions. Gross margins decreased 0.8 percentage points primarily driven by lower revenues from higher margin license products in our Enterprise and Mobile and Consumer businesses.

Cost of Professional Services and Hosting Revenue

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

	Three Months Ended December 31,		Dollar Change	Percent Change
	2013	2012		
Cost of professional services and hosting revenue	$154.6	$125.2	$29.4	23.5%
As a percentage of professional services and hosting revenue	70.9 %	62.5 %		

The increase in the cost of professional services and hosting revenue for the three months ended December 31, 2013, as compared to the three months ended December 31, 2012, was due to a $14.2 million increase in Healthcare costs driven primarily by our on-demand solutions, including the impact from our recent acquisitions. Our Mobile and Consumer costs also increased

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$8.3 million driven by investment in our connected services infrastructure, as we continue to fund an increasing volume of large-scale engagements in our mobile business, where the demand for advanced, cloud-based services continues to grow. In addition, stock-based compensation expense increased $4.2 million.

Gross margin decreased 8.4 percentage points primarily driven by investment in our connected services infrastructure in our mobile business, as well as growth in labor costs from our Healthcare on-demand transcription services. We expect this trend to continue through the remainder of fiscal 2014.

Cost of Maintenance and Support Revenue

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

	Three Months Ended December 31,		Dollar Change	Percent Change
	2013	2012		
Cost of maintenance and support revenue	$12.6	$14.8	$(2.2)	(14.9)%
As a percentage of maintenance and support revenue	17.2%	22.7%		

The decrease in cost of maintenance and support revenue for the three months ended December 31, 2013, as compared to the three months ended December 31, 2012, was primarily due to a $1.3 million decrease in stock-based compensation expense.

Research and Development Expense

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

	Three Months Ended December 31,		Dollar Change	Percent Change
	2013	2012		
Research and development expense	$80.5	$68.7	$11.8	17.2%
As a percentage of total revenue	17.1%	14.9%		

The increase in research and development expense for the three months ended December 31, 2013, as compared to the three months ended December 31, 2012, was primarily attributable to an $8.4 million increase in compensation expense, driven by headcount growth, including additional headcount from our recent acquisitions, together with a $1.4 million increase in stock-based compensation expense. We have increased investment in research and development expense to fund cloud-based speech systems and natural language understanding advancements to extend our technology lead.

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 revenues (dollars in millions):

	Three Months Ended December 31,		Dollar Change	Percent Change
	2013	2012		
Sales and marketing expense	$118.9	$117.1	$1.8	1.5%
As a percentage of total revenue	25.3%	25.3%		

The increase in sales and marketing expense for the three months ended December 31, 2013, as compared to the three months ended December 31, 2012, was primarily attributable to a $4.2 million increase in compensation expense, including commission expense, driven primarily by headcount growth, including additional headcount from our recent acquisitions. The increase was offset by a decrease of $2.1 million in marketing and channel program spending and a decrease of $1.6 million in stock-based compensation expense.

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

	Three Months Ended December 31,		Dollar Change	Percent Change
	2013	2012		
General and administrative expense	$44.5	$44.8	$(0.3)	(0.7)%
As a percentage of total revenue	9.5%	9.7%		

General and administrative expense for the three months ended December 31, 2013, as compared to the three months ended December 31, 2012, was flat.

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):

	Three Months Ended December 31,		Dollar Change	Percent Change
	2013	2012		
Cost of revenue	$15.2	$16.3	$(1.1)	(6.7)%
Operating expenses	27.5	25.4	2.1	8.3 %
Total amortization expense	$42.7	$41.7	$1.0	2.4 %
As a percentage of total revenue	9.1%	9.0%		

The increase in amortization of intangible assets in our operating expenses for the three months ended December 31, 2013, as compared to the three months ended December 31, 2012, was primarily attributable to the amortization of acquired intangible assets from our acquisitions during the period that have higher relative allocations of fair value to customer relationships.

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 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 third-party costs related to the acquisition, and 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):

	Three Months Ended December 31,		Dollar Change	Percent Change
	2013	2012		
Transition and integration costs	$3.9	$6.3	$(2.4)	(38.1)%
Professional service fees	3.3	9.4	(6.1)	(64.9)%
Acquisition-related adjustments	(4.4)	—	(4.4)	N/M
Total acquisition-related costs, net	$2.8	$15.7	$(12.9)	(82.2)%
As a percentage of total revenue	0.6%	3.4%		

The decrease in transition and integration costs for the three months ended December 31, 2013, as compared to the three months ended December 31, 2012, was primarily attributable to $1.2 million of compensation expense related to

a contingent earn-out from our acquisition of Swype for which the earn-out period ended in April 2013. For the three months ended December 31, 2013, professional service fees decreased, compared to the three months ended December 31, 2012, primarily due to fewer acquisitions in the current period.

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Included in Acquisition-related adjustments for the three months ended December 31, 2013, is income of $7.7 million related to the elimination of a contingent liability established in the original allocation of purchase price for an acquisition closed in fiscal 2008, following the expiration of the applicable statute of limitations. As a result, we have eliminated the contingent liability. This income was offset by a $4.1 million expense for a legal settlement related to a previous acquisition for which the measurement period for purchase accounting has ended.

Restructuring and Other Charges, Net

Restructuring and other charges, net include restructuring expenses together with other expenses that are unusual in nature and are the result of unplanned events, and arise outside of the ordinary course of continuing operations. Restructuring expenses consist of employee severance costs and may also include charges for duplicate facilities and other contract termination costs to improve our cost structure prospectively. Other amounts may include gains or losses on sales of non-strategic assets or product lines. The following table sets forth the activity relating to the restructuring accruals included in restructuring and other charges, net for the three months ended December 31, 2013 (dollars in millions):

	Personnel	Facilities	Total
Balance at September 30, 2013	$4.2	$1.2	$5.4
Restructuring charges	1.4	2.4	3.8
Non-cash adjustments	0.1	0.8	0.9
Cash payments	(3.3)	(0.6)	(3.9)
Balance at December 31, 2013	$2.4	$3.8	$6.2

For the three months ended December 31, 2013, we recorded net restructuring charges of $3.8 million, which included a $1.4 million severance charge related to the elimination of approximately 20 personnel across multiple functions and $2.4 million resulting from the restructuring of a facility that will no longer be utilized.

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 gain (loss) from other non-operating activities. The following table shows other income (expense), in dollars and as a percentage of total revenues (dollars in millions):

	Three Months Ended December 31,		Dollar Change	Percent Change
	2013	2012		
Interest income	$0.4	$0.5	$(0.1)	(20.0)%
Interest expense	(34.0)	(34.1)	0.1	(0.3)%
Other expense, net	(3.1)	(3.3)	0.2	(6.1)%
Total other expense, net	$(36.7)	$(36.9)	$0.2	(0.5)%
As a percentage of total revenue	7.8%	8.0%		

For the three months ended December 31, 2013 as compared to the three months ended December 31, 2012, interest expense was essentially flat as additional interest expense on the $350.0 million of Senior Notes issued in the first quarter of fiscal 2013 was offset by lower interest expense following the $143.5 million prepayment of the term loans in the first quarter of fiscal 2013.

Provision (Benefit) from Income Taxes

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

	Three Months Ended December 31,		Dollar Change	Percent Change
	2013	2012		
Provision (benefit) from income taxes	$3.0	$(8.6)	$11.6	(134.9)%
Effective income tax rate	(5.7)%	27.9%		

The effective income tax rate was (5.7)% and 27.9% for the three months ended December 31, 2013 and December 31, 2012, respectively. Our current effective tax rate was lower than the U.S. federal statutory rate of 35% primarily due to earnings in foreign operations which are subject to a significantly lower tax rate than the U.S. statutory tax rate driven primarily by our

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subsidiaries in Ireland. The effective tax rate for the three months ended December 31, 2013 was also impacted by a $5.2 million benefit for income taxes due to the release of a portion of the domestic valuation allowance resulting from a one-time tax benefit recorded in connection with an immaterial acquisition for which a net deferred tax liability was established related to acquired intangible assets.

Our effective income tax rate is influenced by the level and mix of earnings and losses by taxing jurisdiction in combination with the applicable differences between U.S. and foreign tax rates. Accordingly, changes in the jurisdictional mix of pre-tax income in the current year can result in pre-tax income being higher or lower than the prior year in countries with lower statutory tax rates, which causes our effective income tax rate to fluctuate. The impact of such changes could be meaningful in countries with statutory income tax rates that are significantly lower than the U.S. statutory income tax rate of 35%. For the three months ended December 31, 2013, our international profits are lower as compared to the three months ended December 31, 2012, and therefore, the impact on our effective tax rate from our foreign operations is lower in the first quarter of fiscal 2014.

In future periods, if our foreign profits grow, we expect substantially all of our income before income taxes from foreign operations will be earned in Ireland. The statutory rate related to our Ireland profits is lower than the U.S, statutory rate and as a result we would expect our effective tax rate to decrease as profits in Ireland increase.

SEGMENT ANALYSIS

We operate in, and report financial information for, the following four reportable segments: Healthcare, Mobile and Consumer, Enterprise and Imaging.

Segment revenues include 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 we would have otherwise recognized had we not acquired intellectual property and other assets from the same customer. 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 evaluating management performance.

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Segment profit is an important measure used for evaluating performance and for decision-making purposes. 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 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. The following table presents segment results (dollars in millions):

	Three Months Ended December 31,		Change	Percent Change
	2013	2012		
Segment Revenues				
Healthcare	$227.3	$217.4	$9.9	4.6 %
Mobile and Consumer	115.3	131.7	(16.4)	(12.5)%
Enterprise	89.2	83.7	5.5	6.6 %
Imaging	58.3	59.6	(1.3)	(2.2)%
Total segment revenues	490.1	492.4	(2.3)	(0.5)%
Acquisition-related revenues adjustments	(20.1)	(30.1)	10.0	(33.2)%
Total revenues	$470.0	$462.3	$7.7	1.7 %
Segment Profit				
Healthcare	$78.5	$89.1	$(10.6)	(11.9)%
Mobile and Consumer	13.4	39.8	(26.4)	(66.3)%
Enterprise	21.1	21.7	(0.6)	(2.8)%
Imaging	22.7	23.1	(0.4)	(1.7)%
Total segment profit	$135.7	$173.7	$(38.0)	(21.9)%
Segment Profit Margin				
Healthcare	34.5 %	41.0 %	(6.5)	
Mobile and Consumer	11.6 %	30.2 %	(18.6)	
Enterprise	23.7 %	25.9 %	(2.2)	
Imaging	38.9 %	38.8 %	0.1	
Total segment profit margin	27.7 %	35.3 %	(7.6)	

Segment Revenue

- Healthcare segment revenue increased $9.9 million for the three months ended December 31, 2013, as compared to the three months ended December 31, 2012, primarily attributable to revenue growth in our product and licensing and on-demand solutions. Product and licensing revenue increased $3.7 million primarily driven by increased sales of our clinical documentation solutions and Clintegrity solutions. Professional services and hosting revenue increased $3.6 million due to additional on-demand transactional volume resulting from our acquisitions during fiscal 2013.

- Mobile and Consumer segment revenue decreased $16.4 million for the three months ended December 31, 2013, as compared to the three months ended December 31, 2012. Our product and licensing revenue declined $19.6 million, driven primarily by a $10.4 million decrease in sales of our Dragon desktop consumer products following the successful new product launch in the fall of 2012 and an overall weakness in desktop software sales. In addition, embedded license sales in the automotive and handset business decreased $9.0 million as our markets and customers continued to shift toward mobile connected services. Our professional services and hosting revenue grew $2.3 million, primarily attributable to an increase of $4.3 million in on-demand revenue driven by transactional volume growth in our connected mobile services, including the impact from our recent acquisitions, offset by a $2.1 million decrease in professional services revenues.

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Enterprise segment revenue increased $5.5 million for the three months ended December 31, 2013, as compared to the three months ended December 31, 2012. Professional services and hosting revenue increased $12.4 million driven by our recent acquisitions. Product and licensing revenue decreased $9.4 million as a result of lower sales of our on-premise solutions.

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- Imaging segment revenue decreased $1.3 million for the three months ended December 31, 2013, as compared to the three months ended December 31, 2012, as a result of a decrease of $3.1 million in product and licensing revenue, offset by a $1.6 million increase in maintenance and support revenue.

Segment Profit

Healthcare segment profit for the three months ended December 31, 2013 decreased 11.9% from the same period last year, primarily driven by increased costs from growth in sales of our on-demand solutions and increased investments in research and development. Segment profit margin decreased 6.5 percentage points, from 41.0% last year to 34.5% during the current period. The decrease in margin was primarily driven by a decrease of 5.0 percentage points in segment gross margin due to growth in labor costs associated with our on-demand transcription solutions. In addition, margin decreased 0.8 percentage points due to increased investments in research and development to fund the advancement of clinical language understanding and 0.7 percentage points due to higher selling expense.

Mobile and Consumer segment profit for the three months ended December 31, 2013 decreased 66.3% from the same period last year, driven by lower product and licensing revenue and increased costs to support the growth of our on-demand services. Segment profit margin decreased 18.6 percentage points, from 30.2% last year to 11.6% during the current period. The decrease in margin was primarily driven by an 8.4 percentage point decrease in segment gross margin as our markets and customers continued to shift from embedded to on-demand solutions and costs to deploy large custom solutions for key customers, as well as an 8.0 percentage point increase in research and development spending to fund cloud-based speech systems and natural language understanding advancements.

Enterprise segment profit for the three months ended December 31, 2013 decreased 2.8% from the same period last year driven by our recent acquisitions. Segment profit margin decreased 2.2 percentage points, from 25.9% last year to 23.7% in the current period. The decrease in segment profit margin was driven by our recent acquisitions resulting in an increase of 1.4 percentage points in selling and marketing expense and 0.8 percentage points in research and development expense.

Imaging segment profit for the three months ended December 31, 2013 decreased 1.7% from the same period last year. Segment profit margin of 38.9% in the current period was relatively flat as compared to the same period last year.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents and marketable securities totaled $775.1 million as of December 31, 2013, a decrease of $71.7 million as compared to $846.8 million as of September 30, 2013. Our working capital was $524.8 million as of December 31, 2013, as compared to $604.3 million as of September 30, 2013. Cash and cash equivalents held by our international operations totaled $65.5 million and $65.8 million at December 31, 2013 and September 30, 2013, respectively. We expect the cash held overseas will continue to be used for our international operations and therefore do not anticipate repatriating these funds. If we were to repatriate these funds, we do not believe that the resulting withholding taxes payable would have a material impact to our liquidity. As of December 31, 2013, our total accumulated deficit was $433.2 million. We do not expect our accumulated deficit to impact our future ability to operate the business given our strong cash and operating cash flow positions, and believe our current cash and cash equivalents on-hand are sufficient to meet our operating needs for at least the next twelve months.

Cash Provided by Operating Activities

Cash provided by operating activities for the three months ended December 31, 2013 was $78.2 million, a decrease of $44.7 million, as compared to cash provided by operating activities of $122.9 million for the three months ended December 31, 2012. The net decrease was primarily driven by the following factors:

- A decrease in cash flows of $28.7 million resulting from higher net loss, exclusive of non-cash adjustment items;
- A decrease in cash flows of $28.5 million generated by changes in working capital excluding deferred revenue; and
- Offset by an increase in cash flows of $12.4 million from an overall increase in deferred revenue.

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Cash Used in Investing Activities

Cash used in investing activities for the three months ended December 31, 2013 was $105.4 million, a decrease of $355.4 million, as compared to cash used in investing activities of $460.8 million for the three months ended December 31, 2012. The net decrease was primarily driven by the following factors:

- A decrease in cash outflows of $346.7 million for business and technology acquisitions during the three months ended December 31, 2013 resulting from fewer acquisitions during the period; and
- An increase in cash inflows of $12.9 million from sales and maturities of our marketable securities and other investments.

Cash (Used in) Provided by Financing Activities

Cash used in financing activities for the three months ended December 31, 2013 was $46.6 million, a decrease of $216.2 million, as compared to cash provided by financing activities of $169.6 million for the three months ended December 31, 2012. The net cash decrease was primarily driven by the following factors:

- A decrease in cash inflows of $352.6 million from the issuance of long-term debt. Total proceeds from the issuance of our 5.375% Senior Notes due 2020 in the three months ended December 31, 2012, net of issuance costs, were $351.7 million;
- An increase in cash outflows related to our share repurchase program announced in April 2013. During the three months ended December 31, 2013, we repurchased 1.1 million shares of our common stock for total cash outflows of $18.0 million;
- Offset by a decrease in cash outflows of $143.5 million for the payment of long-term debt in October 2012; and
- A decrease in cash outflows of $17.4 million as a result of lower cash payments required to net share settle employee equity awards, due to our lower stock price and a decrease in vesting activities during the three months ended December 31, 2013 as compared to the same period in fiscal 2013.

Credit Facilities and Debt

2.75% Convertible Debentures due in 2031

We have $690 million of 2.75% Convertible Debentures due in 2031 (the “2031 Debentures”) that were issued in a private placement. The 2031 Debentures bear interest at 2.75% per year, payable in cash semiannually in arrears, beginning on May 1, 2012. The 2031 Debentures mature on November 1, 2031, subject to the right of the holders to require us to redeem the 2031 Debentures on November 1, 2017, 2021, and 2026.

If converted, the principal amount of the 2031 Debentures is payable in cash and any amounts payable in excess of the $690 million principal amount, will (based on an initial conversion rate, which represents an initial conversion price of approximately $32.30 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 (and only during such fiscal quarter) if the closing sale price of our common stock was more than 130% of the then current conversion price for at least 20 trading days in the period of the 30 consecutive trading days ending on the last trading day of the previous fiscal quarter; (ii) 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 2031 Debentures; or (iv) at the option of the holder at any time on or after May 1, 2031. Additionally, we may redeem the 2031 Debentures, in whole or in part, on or after November 6, 2017 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 2031 Debentures held by such holder on November 1, 2017, November 1, 2021, and November 1, 2026 at par plus accrued

and unpaid interest. If we undergo a fundamental change (as described in the indenture for the 2031 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 December 31, 2013, 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.

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2.75% Convertible Debentures due in 2027

We have $250 million of 2.75% convertible senior debentures due in 2027 ("the 2027 Debentures") that were issued in a private placement. 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. We have classified the obligation in current liabilities at December 31, 2013 and September 30, 2013.

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 approximately $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 (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 at par plus accrued and unpaid interest. 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 December 31, 2013, 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

The Credit Facility includes a term loan and a $75 million revolving credit line, including letters of credit. The term loans mature on August 7, 2019 and the revolving credit line matures on August 7, 2018. As of December 31, 2013, there were $7.2 million of letters of credit issued, and there were no other outstanding borrowings under the revolving credit line.

Under terms of the amended and restated 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 corporate base rate of Morgan Stanley, the Administrative Agent, 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 at December 31, 2013 is as follows:

Description	Base Rate Margin	LIBOR Margin
Term loans maturing August 2019	1.75%	2.75%
Revolving facility due August 2018	0.50% - 0.75% (a)	1.50% - 1.75% (a)

(a) The margin is determined based on our net leverage ratio at the date the interest rates are reset on the revolving credit line.

At December 31, 2013 the applicable margin for the term loans was 2.75%, with an effective rate of 2.92%, on the outstanding balance of $481.0 million maturing in August 2019. 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 December 31, 2013, the commitment fee rate was 0.375%.

The Credit Facility contains the most restrictive covenants of our long-term debt, including, among other things, covenants that restrict our ability and those of our subsidiaries to incur certain additional indebtedness or issue

guarantees, 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, or merge or consolidate with any entity, and limits transactions with affiliates. 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 December 31, 2013, we were in compliance with the covenants under the Credit Facility. The covenants on our other long-term debt are less restrictive, and we have met these requirements.

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

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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 Credit Facility includes a provision for an annual excess cash flow sweep, as defined in the agreement, payable in the first quarter of each fiscal year, based on the excess cash flow generated in the previous fiscal year. No excess cash flow sweep was required in the first quarter of fiscal 2014 as no excess cash flow, as defined in the agreement, was generated in fiscal 2013. At the current time, we are unable to predict the amount of the outstanding principal, if any, that we may be required to repay in future fiscal years pursuant to the excess cash flow sweep provisions.

Share Repurchase Program

On April 29, 2013, our Board of Directors approved a share repurchase program for up to $500 million of our outstanding shares of common stock. Approximately $295.9 million remained available for stock repurchases as of December 31, 2013 pursuant to our stock repurchase program. We repurchased 1.2 million shares for $19.7 million during the three months ended December 31, 2013 (including 0.1 million shares for $1.7 million that were repurchased, but not settled at December 31, 2013). Under the terms of the repurchase program, we expect to continue to repurchase shares from time to time through a variety of methods, which may include open market purchases, privately negotiated transactions, block trades, accelerated stock repurchase transactions, or any combination of such methods. The timing and the amount of any purchases will be determined by management based on an evaluation of market conditions, capital allocation alternatives, and other factors. The share repurchase program does not require us to acquire any specific number of shares and may be modified, suspended, extended or terminated by us at any time without prior notice.

Off-Balance Sheet Arrangements, Contractual Obligations

Contingent Liabilities and Commitments

In connection with some of our acquisitions, we agree 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 J.A. Thomas ("JA Thomas") in October 2012, we agreed to make deferred payments to the former shareholders of JA Thomas of up to $25.0 million in October 2014, contingent upon the continued employment of certain named executives and certain other conditions. The contingent payments will be reduced by amounts specified in the merger agreement in the event that any of the named executives terminates their employment prior to the payment date.

Off-Balance Sheet Arrangements

Through December 31, 2013, 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

Generally accepted accounting principles in the United States (GAAP) require us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. On an ongoing basis, we evaluate our estimates, assumptions and judgments, including those related to: revenue recognition; allowance for doubtful accounts and sales returns; the valuation of goodwill and intangible 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.

Information about those accounting policies we deem to be critical to our financial reporting may be found in our Annual Report on Form 10-K for the fiscal year ended September 30, 2013. There have been no significant changes or additions to our critical accounting policies from those disclosed in our annual report.

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RECENTLY ISSUED ACCOUNTING STANDARDS

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

Exchange Rate Sensitivity

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

A hypothetical change of 10% in appreciation or depreciation in foreign currency exchange rates from the quoted foreign currency exchange rates at December 31, 2013 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. We have a program that primarily utilizes foreign currency forward contracts to offset the risks associated with the effect of certain foreign currency exposures that arise from transactions denominated in currencies other than the functional currencies of our worldwide operations. We commenced this program so that increases or decreases in our foreign currency exposures are offset by gain or losses on the foreign currency forward contracts. These contracts are not designated as accounting hedges and generally are for periods less than 90 days. The notional contract amount of outstanding foreign currency exchange contracts not designated as cash flow hedges was $330.8 million at December 31, 2013. Based on the nature of the transactions 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, marketable securities and the outstanding debt under the Credit Facility.

At December 31, 2013, we held approximately $775.1 million of cash and cash equivalents and marketable securities 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. Assuming a one percentage point increase in interest rates, our interest income on our investments classified as cash and cash equivalents and marketable securities would increase by approximately $6.6 million per annum, based on the December 31, 2013 reported balances of our investment accounts.

At December 31, 2013, our total outstanding debt balance exposed to variable interest rates was $481.0 million. A hypothetical one percentage point increase in interest rates would result in an increase in our interest expense relative to our outstanding variable rate debt of $4.8 million per annum.

Equity Price Risk

We are exposed to equity price risk as a result of security price guarantees that we enter into 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 December 31, 2013, we have security price guarantees outstanding covering approximately 0.9 million shares. 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.

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2027 and 2031 Debentures

The fair value of our 2031 and 2027 Debentures 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 the stated trigger price for each issuance 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 December 31, 2013 was $672.3 million for the 2031 Debentures and $262.6 million for the 2027 Debentures, based on an average of the bid and ask prices for each of the issuances on that day. This compares to conversion values on December 31, 2013 of approximately $324.7 million and $195.2 million for the 2031 Debentures and the 2027 Debentures, respectively. A 10% increase in the stock price over the December 31, 2013 closing price of $15.20 would have an estimated combined $14.3 million increase to the fair value and a combined $52.0 million increase to the conversion value of the debentures.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

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

Changes in internal control over financial reporting

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

Part II. Other Information

Item 1.Legal Proceedings

This information is included in Note 16, Commitments and Contingencies, in the accompanying notes to unaudited consolidated financial statements and is incorporated herein by reference from Item 1 of Part I.

Item 1A. Risk Factors

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

shares held by you.

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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, bookings 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, bookings 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 and receipt of royalty reports;
- our ability to generate additional revenue from our intellectual property portfolio;
- customers delaying their purchasing decisions in anticipation of new versions of our products;
- 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, bookings 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.

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 and bookings plans of the acquired entity in the due diligence process;

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- 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 may adversely affect our operating results and 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;
- 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 December 31, 2013, we had identified intangible assets of approximately $954.3 million, net of accumulated amortization, and goodwill of approximately $3.4 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.

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 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 December 31, 2013, we had a total of $2,471.0 million of gross debt outstanding, $481.0 million in term loans due in August 2019, $1,050.0 million of senior notes due in 2020 and $940.0 million in convertible debentures. Investors may require us to redeem the 2027 Debentures totaling $250.0 million in aggregate principal amount in August 2014, or sooner if the closing sale price of our common stock is more

than 120% of the then current conversion price for certain specified periods. If a holder elects to convert, we will be required to pay the principal amount in cash and any amounts

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payable in excess of the principal amount will be paid in cash or shares of our common stock, at our election. Investors may require us to redeem the 2031 Debentures, totaling $690.0 million in aggregate principal amount in November 2017, or sooner if the closing sale price of our common stock is more than 130% of the then current conversion price for certain specified periods. If a holder elects to convert, we will be required to pay the principal amount in cash and any amounts payable in excess of the principal amount will be paid in cash or shares of our common stock, at our election. We also have a $75.0 million revolving credit line available to us through August 2018. As of December 31, 2013, there were $7.2 million of letters of credit issued, but there were no other outstanding borrowings under the revolving credit line. Our debt level could have important consequences, for example it could:

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

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

In addition, approximately $481.0 million of our debt outstanding as of December 31, 2013 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 limitations 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 limitations, 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 our debt 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 loss of $115.2 million in fiscal 2013, and net income of $207.1 million and $38.2 million in fiscal 2012 and 2011, respectively, and have a total accumulated deficit of $433.2 million as of December 31, 2013. If we

are unable to return to

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profitability, the market price for our stock may decline, perhaps substantially. We cannot assure you that our revenue or bookings will grow or that we will return to profitability in the future. If we do not achieve 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 and bookings 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, Google, Microsoft, and other smaller providers. Within healthcare, we compete with 3M, M*Modal 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 3M, Adobe, Google and Microsoft, 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 Google and Microsoft, have developed or acquired products or technologies that compete with our products and technologies. These customers may give higher priority to the sale of their competitive products or technologies. To the extent they do so, market acceptance and penetration of our products, and therefore our revenue and bookings, 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

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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 and bookings are 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 and bookings from international operations could increase in the future. Most of our international revenue and bookings are 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, Germany and United Kingdom that provide professional services. A significant portion of the development of our voice and language products is conducted in Canada and Germany, and a significant portion of our imaging research and development is conducted in Hungary. We also have significant research and development resources in Austria, Belgium, 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;
- 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 and 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.

Tax matters may cause significant variability in our financial results.

Our businesses are subject to income taxation in the U.S., as well as in many tax jurisdictions throughout the world. Tax rates in these jurisdictions may be subject to significant change. Our effective income tax rate can vary significantly between periods due to a number of complex factors including, but not limited to: (i) projected levels of taxable income; (ii) pre-tax income being lower than anticipated in countries with lower statutory rates or higher than anticipated in countries with higher statutory rates; (iii) increases or decreases to valuation allowances recorded against deferred tax assets; (iv) tax audits conducted by various tax authorities; (v) adjustments to income taxes upon finalization of income tax returns; (vi) the ability to claim foreign tax credits; and (vii) the repatriation of non-U.S. earnings for which we have not previously provided for income taxes. If our effective tax rate increases, our operating results and cash flow could be adversely affected.

We are subject to laws and regulations worldwide, changes to which could increase our costs and adversely affect our business.

We are subject to laws and regulations affecting our domestic and international operations in a number of areas. These U.S. and foreign laws and regulations affect various aspects of our business including, but not limited to, areas of labor, advertising, digital content, consumer protection, real estate, billing, e-commerce, promotions, quality of services, telecommunications, mobile communications and media, intellectual property ownership and infringement,

import and export requirements, anti-corruption, foreign exchange controls and cash repatriation restrictions, data privacy requirements, anti-competition, environmental, health and safety.

Compliance with these laws, regulations and similar requirements may be onerous and expensive, and they may be inconsistent from jurisdiction to jurisdiction, further increasing the cost of compliance and doing business. Any such costs, which may rise in the future as a result of changes in these laws and regulations or in their interpretation could individually or in the aggregate make

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our products and services less attractive to our customers, delay the introduction of new products in one or more regions, or cause us to change or limit our business practices. We have implemented policies and procedures designed to ensure compliance with applicable laws and regulations, but there can be no assurance that our employees, contractors, or agents will not violate such laws and regulations or our policies and procedures.

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 and bookings 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 business is subject to a variety of U.S. and international laws, rules, policies and other obligations regarding data protection.

We are subject to federal, state and international laws relating to the collection, use, retention, disclosure, security and transfer of personally identifiable information. In many cases, these laws apply not only to third-party transactions, but also to transfers of information between the Company and its subsidiaries, and among the Company, its subsidiaries and other parties with which we have relations. Several jurisdictions have passed laws in this area, and other

jurisdictions are considering imposing additional restrictions. These laws continue to evolve and may be inconsistent from jurisdiction to jurisdiction. Complying with emerging and changing requirements may cause us to incur substantial costs or require us to change our business practices. Noncompliance could result in penalties or significant legal liability.

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Any failure by us, our suppliers or other parties with whom we do business to comply with our privacy policy or with other federal, state or international privacy-related or data protection laws and regulations could result in proceedings against us by governmental entities or others.

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 primarily includes investments in money market funds, 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 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 or policies 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 confidential 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.

Interruptions or delays in service from data center hosting facilities could impair the delivery of our service and harm our business.

We currently serve our customers from data center hosting facilities. Any damage to, or failure of, our systems generally could result in interruptions in our service. Interruptions in our service may reduce our revenue, cause us to issue credits or pay penalties, cause customers to terminate their on-demand services and adversely affect our renewal rates and our ability to attract new customers.

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,

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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 and bookings, 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 and bookings, 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 them to influence matters requiring stockholder approval.

As of December 31, 2013, High River Limited Partnership, Hopper Investments LLC, Barberry Corp., Icahn Partners LP, Icahn Partners Master Fund LP, Icahn Partners Master Fund II LP, Icahn Partners Master Fund III LP, Icahn Enterprises G.P. Inc., Icahn Enterprises Holdings L.P., IPH GP LLC, Icahn Capital LP, Icahn Onshore LP, Icahn Offshore LP, and Beckton Corp. (collectively, the “Icahn Group”), beneficially owned approximately 19% of the outstanding shares of our common stock. Brett Icahn and David Schechter of the Icahn Group have been appointed as directors of the Company. Because of its large holdings of our capital stock relative to other stockholders, the Icahn Group has a strong influence over matters requiring approval by our stockholders.

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

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

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

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

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

Future sales of substantial amounts of our common stock in the public market, or the perception that such sales could occur, could adversely affect prevailing trading prices of our common stock and could impair our ability to raise capital through future offerings of equity or equity-related securities. In connection with past acquisitions, we issued a substantial number of shares of our common stock as transaction consideration. We may continue to issue equity securities for future acquisitions, which would dilute existing stockholders, perhaps significantly depending on the terms of such acquisitions. 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.

Our business could be negatively affected as a result of the actions of activist stockholders.

Responding to actions by activist stockholders can be costly and time-consuming, disrupting our operations and diverting the attention of management and our employees. Furthermore, any perceived uncertainties as to our future direction could result in the loss of potential business opportunities, and may make it more difficult to attract and retain qualified personnel and business partners.

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.

In addition, on August 19, 2013, we implemented a stockholder rights plan, also called a poison pill, that may have the effect of discouraging or preventing a change of control by, among other things, making it uneconomical for a third party to acquire us without the consent of our Board of Directors.

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

The following is a summary of our share repurchases for the three months ended December 31, 2013:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program (1)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
October 1, 2013 - October 31, 2013	1,072,231	$16.79	1,072,231	$297,612,099.68
November 1, 2013 - November 30, 2013	—	$—	—	$297,612,099.68
December 1, 2013 - December 31, 2013	111,263	$14.96	111,263	$295,947,468.89
Total	1,183,494		1,183,494	$295,947,468.89

(1) On April 30, 2013, we announced a share repurchase program for up to $500 million of our outstanding shares of common stock. The plan has no expiration date.

For the majority of restricted stock units granted to employees, the number of shares issued on the date the restricted stock units vest is net of the minimum statutory income withholding tax requirements that we pay in cash to the applicable taxing authorities on behalf of our employees. We do not consider these transactions to be common stock repurchases.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

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

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized, in the Town of Burlington, Commonwealth of Massachusetts, on February 10, 2014.

Nuance Communications, Inc.

By: /s/ Thomas L. Beaudoin
Thomas L. Beaudoin
Executive Vice President and Chief Financial Officer

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EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
3.1	Amended and Restated Certificate of Incorporation of the Registrant.	10-Q	0-27038	3.2	5/11/2001	
3.2	Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Registrant.	10-Q	0-27038	3.1	8/9/2004	
3.3	Certificate of Ownership and Merger.	8-K	0-27038	3.1	10/19/2005	
3.4	Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Registrant.	S-3	333-142182	3.3	4/18/2007	
3.5	Amended and Restated Bylaws of the Registrant.	8-K	0-27038	3.1	11/13/2007	
3.6	Certificate of Elimination of the Series A Participating Preferred Stock	8-K	02-27038	3.1	8/20/2013	
3.7	Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock	8-K	02-27038	3.2	8/20/2013	
10.1	Nomination and Standstill Agreement Dated October 7, 2013 by and between Nuance Communications, Inc., High River Limited Partnership, Hopper Investments LLC, Barberry Corp., Icahn Partners LP, Icahn Partners Master Fund LP, Icahn Partners Master Fund II LP, Icahn Partners Master Fund III LP, Icahn Enterprises G.P. Inc., Icahn Enterprises Holdings L.P., IPH GP LLC, Icahn Capital LP, Icahn Onshore LP, Icahn Offshore LP, and Beckton Corp.	8-K	001-36056	99.1	10/8/2013	
10.2	Confidentiality Agreement Dated October 7, 2013 by and between Nuance Communications, Inc., Carl C. Icahn, Brett Icahn, David Schechter, High River Limited Partnership, Hopper Investments LLC, Barberry Corp., Icahn Partners LP, Icahn Partners Master Fund LP, Icahn Partners Master Fund II LP, Icahn Partners Master Fund III LP, Icahn Enterprises G.P. Inc., Icahn Enterprises Holdings L.P., IPH GP LLC, Icahn Capital LP, Icahn Onshore LP, Icahn Offshore LP, and Beckton Corp.	8-K	001-36056	99.2	10/8/2013	
10.3	Amendment No. 1 to Employment Agreement, dated November 12, 2013 by and between Nuance Communications, Inc. and Paul A. Ricci.*					X

10.4	Retention Agreement, dated November 12, 2013 by and between Nuance Communications, Inc. and Janet Connor. *	X
10.5	Form of Change of Control and Severance Agreement for Executive Officers.*	X
10.6	1995 Directors' Stock Option Plan, as amended and restated on November 13, 2013.*	X
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a).	X
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a).	X
32.1	Certification Pursuant to 18 U.S.C. Section 1350.	X

101	The following materials from Nuance Communications, Inc.'s Quarterly Report on Form 10-Q for the quarter ended December 31, 2012, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Operations, (ii) the Consolidated Balance Sheets, (iii) the Consolidated Statements of Cash Flows, and (iv) Notes of Consolidated Financial Statements.	X

* Denotes management compensatory plan or arrangement