

Nuance Communications, Inc.  
Form 10-Q  
February 09, 2018

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

Form 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2017

Or

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

Commission file number 000-27038

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

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

1 Wayside Road 01803  
Burlington, Massachusetts  
(Address of principal executive offices) (Zip Code)  
Registrant's telephone number, including area code:  
(781) 565-5000

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Large accelerated filer  Accelerated filer  Emerging growth company

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

The number of shares of the Registrant's Common Stock, outstanding as of January 31, 2018 was 293,699,330.

---

NUANCE COMMUNICATIONS, INC.  
TABLE OF CONTENTS

	Page
<b><u>PART I: FINANCIAL INFORMATION</u></b>	
Item 1. Condensed Consolidated Financial Statements (unaudited):	
Consolidated Statements of Operations for the three months ended December 31, 2017 and 2016	1
Consolidated Statements of Comprehensive Income (Loss) for the three months ended December 31, 2017 and 2016	2
Consolidated Balance Sheets at December 31, 2017 and September 30, 2017	3
Consolidated Statements of Cash Flows for the three months ended December 31, 2017 and 2016	4
<u>Notes to Condensed Consolidated Financial Statements</u>	5
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	21
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	33
Item 4. <u>Controls and Procedures</u>	34
<b><u>PART II: OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	34
Item 1A. <u>Risk Factors</u>	34
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	43
Item 3. <u>Defaults Upon Senior Securities</u>	43
Item 4. <u>Mine Safety Disclosures</u>	43
Item 5. <u>Other Information</u>	43
Item 6. <u>Exhibits</u>	44
<u>Exhibit Index</u>	44
<u>Signatures</u>	45
Certifications	

---

Table of Contents

NUANCE COMMUNICATIONS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended December 31,	
	2017	2016
	(Unaudited)	
	(In thousands, except per share amounts)	
Revenues:		
Professional services and hosting	\$259,027	\$253,417
Product and licensing	161,810	151,752
Maintenance and support	80,808	82,489
Total revenues	501,645	487,658
Cost of revenues:		
Professional services and hosting	172,528	164,892
Product and licensing	19,069	18,378
Maintenance and support	14,241	13,598
Amortization of intangible assets	15,356	15,542
Total cost of revenues	221,194	212,410
Gross profit	280,451	275,248
Operating expenses:		
Research and development	73,366	66,322
Sales and marketing	101,960	101,516
General and administrative	52,892	39,790
Amortization of intangible assets	23,064	27,859
Acquisition-related costs, net	5,561	9,026
Restructuring and other charges, net	14,801	6,703
Total operating expenses	271,644	251,216
Income from operations	8,807	24,032
Other (expense) income:		
Interest income	2,192	1,023
Interest expense	(36,070 )	(38,021 )
Other expense, net	(222 )	(610 )
Loss before income taxes	(25,293 )	(13,576 )
(Benefit) provision for income taxes	(78,521 )	10,353
Net income (loss)	\$53,228	\$(23,929 )
Net income (loss) per share:		
Basic	\$0.18	\$(0.08 )
Diluted	\$0.18	\$(0.08 )
Weighted average common shares outstanding:		
Basic	291,367	288,953
Diluted	295,995	288,953

See accompanying notes.

1

---

Table of Contents

NUANCE COMMUNICATIONS, INC.  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three Months Ended December 31, 2017      2016 (Unaudited) (In thousands)	
Net income (loss)	\$53,228	\$(23,929)
Other comprehensive income (loss):		
Foreign currency translation adjustment	1,515	(30,566 )
Pension adjustments	116	118
Unrealized loss on marketable securities	(277 )	(31 )
Total other comprehensive income (loss), net	1,354	(30,479 )
Comprehensive income (loss)	\$54,582	\$(54,408)

See accompanying notes.

2

---

Table of ContentsNUANCE COMMUNICATIONS, INC.  
CONSOLIDATED BALANCE SHEETS

	December 31, 2017	September 30, 2017
	(Unaudited)	
	(In thousands, except per share amounts)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 398,461	\$ 592,299
Marketable securities	112,044	251,981
Accounts receivable, less allowances for doubtful accounts of \$13,013 and \$14,333	432,552	395,392
Prepaid expenses and other current assets	105,411	88,269
Total current assets	1,048,468	1,327,941
Marketable securities	42,115	29,844
Land, building and equipment, net	172,748	176,548
Goodwill	3,600,768	3,590,608
Intangible assets, net	627,556	664,474
Other assets	145,902	142,508
Total assets	\$5,637,557	\$ 5,931,923
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$—	\$ 376,121
Contingent and deferred acquisition payments	15,506	28,860
Accounts payable	82,674	94,604
Accrued expenses and other current liabilities	193,406	245,901
Deferred revenue	427,541	366,042
Total current liabilities	719,127	1,111,528
Long-term debt	2,299,594	2,241,283
Deferred revenue, net of current portion	453,106	423,929
Deferred tax liabilities	35,769	131,320
Other liabilities	104,830	92,481
Total liabilities	3,612,426	4,000,541
Commitments and contingencies (Note 15)		
Stockholders' equity:		
Common stock, \$0.001 par value per share; 560,000 shares authorized; 297,243 and 293,938 shares issued and 293,492 and 290,187 shares outstanding, respectively	297	294
Additional paid-in capital	2,669,291	2,629,245
Treasury stock, at cost (3,751 shares)	(16,788 )	(16,788 )
Accumulated other comprehensive loss	(99,988 )	(101,342 )
Accumulated deficit	(527,681 )	(580,027 )
Total stockholders' equity	2,025,131	1,931,382
Total liabilities and stockholders' equity	\$5,637,557	\$ 5,931,923



See accompanying notes.

3

---

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

	Three Months Ended December 31,	
	2017	2016
	(Unaudited)	
	(In thousands)	
Cash flows from operating activities:		
Net income (loss)	\$53,228	\$(23,929)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	54,315	58,006
Stock-based compensation	37,986	39,130
Non-cash interest expense	13,341	13,039
Deferred tax (benefit) provision	(97,226)	2,006
Other	631	1,856
Changes in operating assets and liabilities, excluding effects of acquisitions:		
Accounts receivable	(36,340)	(9,713)
Prepaid expenses and other assets	(18,972)	(15,999)
Accounts payable	(11,856)	(21,244)
Accrued expenses and other liabilities	3,099	5,841
Deferred revenue	87,899	75,907
Net cash provided by operating activities	86,105	124,900
Cash flows from investing activities:		
Capital expenditures	(12,543)	(11,399)
Payments for business and asset acquisitions, net of cash acquired	(8,648)	(22,949)
Purchases of marketable securities and other investments	(32,447)	(72,797)
Proceeds from sales and maturities of marketable securities and other investments	159,805	10,105
Net cash provided by (used in) investing activities	106,167	(97,040)
Cash flows from financing activities:		
Payments and redemption of debt	(331,172)	—
Proceeds from issuance of long-term debt, net of issuance costs	—	495,000
Acquisition payments with extended payment terms	(16,880)	—
Net payments on other long-term liabilities	(65)	(87)
Proceeds from issuance of common stock from employee stock plans	6	45
Cash used to net share settle employee equity awards	(38,617)	(40,360)
Net cash (used in) provided by financing activities	(386,728)	454,598
Effects of exchange rate changes on cash and cash equivalents	618	(2,471)
Net (decrease) increase in cash and cash equivalents	(193,838)	479,987
Cash and cash equivalents at beginning of period	592,299	481,620
Cash and cash equivalents at end of period	\$398,461	\$961,607

See accompanying notes.

4

---

Table of Contents

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Presentation

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

Although we believe the disclosures included herein are adequate to ensure that the condensed consolidated financial statements are fairly presented, certain information and footnote disclosures to the financial statements have been condensed or omitted in accordance with the rules and regulations of the SEC. Accordingly, the condensed consolidated financial statements and the footnotes included herein should be read in conjunction with the audited financial statements and the footnotes included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2017. The results of operations for the three months ended December 31, 2017 and 2016, are not necessarily indicative of the results for the entire fiscal year or any future period.

2. Summary of Significant Accounting Policies

Recently Adopted Accounting Standards

In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory" ("ASU 2016-16"), which requires income tax consequences of inter-company transfers of assets other than inventory to be recognized when the transfer occurs. ASU 2016-16 is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. We early adopted the guidance during the first quarter of fiscal year 2018. As a result, deferred tax liabilities of \$0.9 million arising from inter-company transfers in prior years were recognized and recorded against the beginning balance of accumulated deficit in the first quarter of fiscal year 2018. The adoption of the guidance does not have a material impact on our consolidated financial statements for any period presented.

Recently Issued Accounting Standards

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15"), which is effective for fiscal years beginning after December 15, 2017 and the interim periods therein, with early adoption permitted. The guidance requires cash flows with multiple characteristics to be classified using a three-step process, including (i) determining whether explicit guidance is applicable, (ii) separating each identifiable source or use of cash flows, and (iii) determining the predominant source or use of cash flows when the source or use of cash flows cannot be separately identifiable. We are still evaluating the impact of the guidance on our consolidated financial statement.

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

such amounts prior to adoption.

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

## NUANCE COMMUNICATIONS, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers: Topic 606" ("ASU 2014-09"), to supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five-step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. ASU 2014-09 permits two methods of adoption: (i) retrospective to each prior reporting period presented; or (ii) retrospective with the cumulative effect of initially applying the guidance recognized at the date of initial application. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date, which deferred the effective date of the new revenue standard for periods beginning after December 15, 2016 to December 15, 2017, with early adoption permitted but not earlier than the original effective date. Accordingly, the updated standard is effective for us in the first quarter of fiscal 2019 and we do not plan to early adopt. In the first quarter of fiscal 2017, we commenced a project to assess the potential impact of the new standard on our consolidated financial statements and related disclosures. This project also includes the assessment and enhancement of our internal processes and systems to address the new standard. While we are continuing to assess all potential impacts of the new standard, we currently believe the most significant impact relates to our accounting for arrangements that include term-based software licenses bundled with maintenance and support. Under current GAAP, the revenue attributable to these software licenses is recognized ratably over the term of the arrangement because vendor-specific objective evidence ("VSOE") does not exist for the undelivered maintenance and support element as it is not sold separately. The requirement to have VSOE for undelivered elements to enable the separation of revenue for the delivered software licenses is eliminated under the new standard. Accordingly, under the new standard we will be required to recognize as revenue a portion of the arrangement fee upon delivery of the software license. While we currently expect revenue related to our professional services and cloud offerings to remain substantially unchanged, we are still in the process of evaluating the impact of the new standard on these arrangements. We plan to adopt this guidance beginning on October 1, 2018 and apply the cumulative catch-up transition method, with a cumulative adjustment to retained earnings as opposed to retrospectively adjusting prior periods.

### 3. Business Acquisitions

We continue to expand our solutions and integrate our technologies in new offerings through acquisitions. A summary of our acquisition activities for the three months ended December 31, 2017 and December 31, 2016 is as follows:

#### Fiscal Year 2018

In the first quarter of fiscal year 2018, we completed an acquisition in our Healthcare segment for a total cash consideration of \$8.7 million and contingent payments at fair value of \$0.5 million. As a result, we recognized goodwill of \$6.8 million, and other intangible assets of \$2.0 million, with a weighted average life of 2.0 years. The acquisition does not have a material impact on our condensed consolidated financial statements for the period.

#### Fiscal Year 2017

In the first quarter of fiscal year 2017, we completed several acquisitions in our Enterprise and Healthcare segments for a total cash consideration of \$24.2 million and contingent payments at fair value of \$1.7 million. As a result, we recognized goodwill of \$15.7 million, and other intangible assets of \$10.4 million, with a weighted average life of 6.0 years. Such acquisitions were not significant individually or in the aggregate.

#### Acquisition-Related Costs, net

Acquisition-related costs include costs related to business acquisitions. These costs consist of (i) transition and integration costs, including retention payments, transitional employee costs and earn-out payments, and other costs related to integration activities; (ii) professional service fees, including financial advisory, legal, accounting, and other outside services incurred in connection with acquisition activities, and disputes and regulatory matters related to acquired entities; and (iii) fair value adjustments to acquisition-related contingencies.



NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

A summary of acquisition-related costs, net is as follows (dollars in thousands):

	Three Months Ended December 31, 2017 2016	
Transition and integration costs	\$4,062	\$3,710
Professional service fees	511	5,017
Acquisition-related adjustments	988	299
Total	\$5,561	\$9,026

4. Goodwill and Intangible Assets

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

	Goodwill	Intangible Assets
Balance at September 30, 2017	\$3,590,608	\$664,474
Acquisitions (Note 3)	6,790	2,000
Purchase accounting adjustments	(348 )	—
Amortization	—	(38,420 )
Effect of foreign currency translation	3,718	(498 )
Balance at December 31, 2017	\$3,600,768	\$627,556

5. Financial Instruments and Hedging Activities

Derivatives Not Designated as Hedges

Forward Currency Contracts

We utilize foreign currency forward contracts to mitigate the risks associated with changes in foreign currency exchange rates. Generally, we enter into such contracts for less than 90 days and have no cash requirements until maturity. At December 31, 2017 and September 30, 2017, we had outstanding contracts with a total notional value of \$82.4 million and \$69.0 million, respectively.

We did not designate any forward contracts as hedging instruments for the three months ended December 31, 2017 or 2016. Therefore, changes in fair value of foreign currency forward contracts were recognized within other expense, net in our condensed consolidated statements of operations. The cash flows related to the settlement of forward contracts not designated as hedging instruments are included in cash flows from investing activities within our consolidated statement of cash flows.

A summary of the derivative instruments as of December 31, 2017 and September 30, 2017 is as follows (dollars in thousands):

Derivatives Not Designated as Hedges:	Balance Sheet Classification	Fair Value	
		December 31, 2017	September 30, 2017
Foreign currency forward contracts	Prepaid expenses and other current assets	\$535	\$220
Foreign currency forward contracts	Accrued expenses and other current liabilities	(65 )	(373 )

A summary of loss related to the derivative instruments for the three months ended December 31, 2017 and 2016 is as follows (dollars in thousands):

Derivatives Not Designated as Hedges	Classification of Loss Recognized in Income	Three Months Ended December 31,	
		2017	2016
Foreign currency forward contracts	Other expense, net	\$(397)	\$(11,615)





## NUANCE COMMUNICATIONS, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## 6. Fair Value Measurements

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

The determination of the applicable level within the hierarchy of a particular financial asset or liability depends on the lowest level of inputs that are significant to the fair value measurement as of the measurement date as follows:

Level 1: Quoted prices for identical assets or liabilities in active markets.

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

Level 3: Unobservable inputs that are supportable by little or no market activities and are based on significant assumptions and estimates.

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

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds <sup>(a)</sup>	\$245,036	\$—	\$—	\$245,036
Time deposits <sup>(b)</sup>	—	99,774	—	99,774
Commercial paper, \$38,069 at cost <sup>(b)</sup>	—	38,182	—	38,182
Corporate notes and bonds, \$83,827 at cost <sup>(b)</sup>	—	83,532	—	83,532
Foreign currency exchange contracts <sup>(b)</sup>	—	535	—	535
Total assets at fair value	\$245,036	\$222,023	\$—	\$467,059
Liabilities:				
Foreign currency exchange contracts <sup>(b)</sup>	\$—	\$(65)	\$—	\$(65)
Contingent acquisition payments <sup>(c)</sup>	—	—	(10,431)	(10,431)
Total liabilities at fair value	\$—	\$(65)	\$(10,431)	\$(10,496)
	September 30, 2017			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds <sup>(a)</sup>	\$381,899	\$—	\$—	\$381,899
Time deposits <sup>(b)</sup>	—	85,570	—	85,570
Commercial paper, \$41,805 at cost <sup>(b)</sup>	—	41,968	—	41,968
Corporate notes and bonds, \$74,150 at cost <sup>(b)</sup>	—	74,067	—	74,067
Foreign currency exchange contracts <sup>(b)</sup>	—	220	—	220
Total assets at fair value	\$381,899	\$201,825	\$—	\$583,724
Liabilities:				
Foreign currency exchange contracts <sup>(b)</sup>	\$—	\$(373)	\$—	\$(373)
Contingent acquisition payments <sup>(c)</sup>	—	—	(8,648)	(8,648)
Total liabilities at fair value	\$—	\$(373)	\$(8,648)	\$(9,021)

(a) Money market funds and time deposits with original maturity of 90 days or less are included within cash and cash equivalents in the consolidated balance sheets, are valued at quoted market prices in active markets.

(b) Time deposits, commercial paper, corporate notes and bonds, and foreign currency exchange contracts are recorded at fair market values, which are determined 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. Time deposits are generally for terms of one year

## NUANCE COMMUNICATIONS, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

or less. Commercial paper and corporate notes and bonds generally mature within three years and have a weighted average maturity of 0.54 years as of December 31, 2017 and 0.72 years as of September 30, 2017.

(c) The fair values of our contingent consideration arrangements were determined using either the option pricing model with Monte Carlo simulation or probability-weighted discounted cash flow method.

As of September 30, 2017, \$80.2 million of debt securities included within marketable securities were designated as held-to-maturity investments, which had a weighted average maturity of 0.27 years and an estimated fair value of \$80.4 million based on Level 2 measurements. No debt securities were designated as held-to-maturity investments as of December 31, 2017.

The estimated fair value of our long-term debt approximated \$2,627.2 million (face value \$2,587.0 million) and \$2,930.9 million (face value \$2,918.1 million) as of December 31, 2017 and September 30, 2017, respectively, based on Level 2 measurements. The fair value of each borrowing was estimated using the averages of the bid and ask trading quotes at each respective reporting date. There was no balance outstanding under our revolving credit agreement as of December 31, 2017 or September 30, 2017.

Additionally, contingent acquisition payments are recorded at fair values upon the acquisition, and remeasured in subsequent reporting periods with the changes in fair values recorded within acquisition-related costs, net. Such payments are contingent upon the achievement of specified performance targets and are valued using the option pricing model with Monte Carlo simulation or the probability-weighted discounted cash flow model.

The following table provides a summary of changes in the aggregate fair value of the contingent acquisition payments for the three months ended December 31, 2017 and 2016 (dollars in thousands):

	Three Months Ended December 31,	
	2017	2016
Balance at beginning of period	\$8,648	\$8,240
Earn-out liabilities established at time of acquisition	500	1,653
Payments and foreign currency translation	(17 )	(1,498 )
Adjustments to fair value included in acquisition-related costs, net	1,300	566
Balance at end of period	\$10,431	\$8,961

Contingent acquisition payments are to be made in periods through fiscal year 2019. As of December 31, 2017, the maximum amount payable based on the agreements was \$25.1 million if the specified performance targets are achieved.

#### 7. Accrued Expenses and Other Current Liabilities

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

	December 31, September 30,	
	2017	2017
Compensation	\$ 103,991	\$ 159,951
Cost of revenue related liabilities	22,066	20,124
Accrued interest payable	21,733	26,285
Consulting and professional fees	19,274	12,649
Facilities related liabilities	5,540	7,158
Sales and marketing incentives	4,190	3,655
Sales and other taxes payable	3,190	3,125
Other	13,422	12,954
Total	\$ 193,406	\$ 245,901

#### 8. Deferred Revenue

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

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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

	December 31, 2017	September 30, 2017
Current liabilities:		
Deferred maintenance revenue	\$ 171,980	\$ 162,958
Unearned revenue	255,561	203,084
Total current deferred revenue	\$ 427,541	\$ 366,042
Long-term liabilities:		
Deferred maintenance revenue	\$ 62,494	\$ 60,298
Unearned revenue	390,612	363,631
Total long-term deferred revenue	\$ 453,106	\$ 423,929

9. Restructuring and Other Charges, net

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

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

	Personnel	Facilities	Total
Balance at September 30, 2017	\$ 1,546	\$ 9,159	\$ 10,705
Restructuring charges, net	4,883	1,665	6,548
Non-cash adjustment	—	(298 )	(298 )
Cash payments	(5,392 )	(1,753 )	(7,145 )
Balance at December 31, 2017	\$ 1,037	\$ 8,773	\$ 9,810

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

	Three Months Ended December 31, 2017				2016					
	Personnel	Facilities	Total Restructuring	Other Charges	Total	Personnel	Facilities	Total Restructuring	Other Charges	Total
Healthcare	\$2,513	\$25	\$ 2,538	\$ —	\$2,538	\$1,984	\$ 277	\$ 2,261	\$ —	\$2,261
Mobile	400	11	411	—	411	213	—	213	—	213
Enterprise	262	2,360	2,622	—	2,622	424	607	1,031	—	1,031
Imaging	1,223	9	1,232	—	1,232	361	351	712	—	712
Corporate	485	(740 )	(255 )	8,253	7,998	669	664	1,333	1,153	2,486
Total	\$4,883	\$1,665	\$ 6,548	\$ 8,253	\$14,801	\$3,651	\$ 1,899	\$ 5,550	\$ 1,153	\$6,703

Fiscal Year 2018

During the three months ended December 31, 2017, we recorded restructuring charges of \$6.5 million, which included \$4.9 million related to the termination of approximately 160 employees and \$1.7 million related to certain excess facilities. These actions were part of our initiatives to reduce costs and optimize processes. We expect the remaining outstanding severance of \$1.0 million to be substantially paid during fiscal year 2018, and the remaining balance of \$8.8 million related to excess facilities to be paid through fiscal year 2025, in accordance with the terms of the applicable leases.

Additionally, during the three months ended December 31, 2017, we recorded \$2.3 million related to the transition agreement of our CEO, and \$6.0 million related to our remediation and restoration efforts after the malware incident that occurred in the third quarter of fiscal year 2017. The cash payments associated with the transition agreement are expected to be made during fiscal years 2018 and 2019.



## NUANCE COMMUNICATIONS, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## Fiscal Year 2017

During the three months ended December 31, 2016, we recorded restructuring charges of \$5.6 million. The restructuring charges for the three months ended December 31, 2016 included \$3.7 million related to the termination of approximately 90 employees and \$1.9 million related to certain excess facilities. These actions were part of our initiatives to reduce costs and optimize processes. The restructuring charges also included \$1.9 million related to excess facilities. In addition, during the three months ended December 31, 2016, we recorded \$1.2 million related to the transition agreement of our CEO.

## 10. Debt

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

	December 31, 2017	September 30, 2017
5.625% Senior Notes due 2026, net of deferred issuance costs of \$5.5 million and \$5.7 million, respectively. Effective interest rate 5.625%.	\$ 494,453	\$ 494,298
5.375% Senior Notes due 2020, net of unamortized premium of \$0.9 million and \$1.0 million, respectively, and deferred issuance costs of \$2.1 million and \$2.3 million, respectively. Effective interest rate 5.375%.	448,748	448,630
6.000% Senior Notes due 2024, net of deferred issuance costs of \$2.0 million and \$2.1 million, respectively. Effective interest rate 6.000%.	297,988	297,910
1.00% Convertible Debentures due 2035, net of unamortized discount of \$135.0 million and \$140.9 million, respectively, and deferred issuance costs of \$6.6 million and \$6.9 million, respectively. Effective interest rate 5.622%.	534,885	528,690
2.75% Convertible Debentures due 2031, net of unamortized discount of \$1.5 million and deferred issuance costs of \$0.1 million as of September 30, 2017. Effective interest rate 7.432%.	46,568	376,121
1.25% Convertible Debentures due 2025, net of unamortized discount of \$90.2 million and \$92.7 million, respectively, and deferred issuance costs of \$4.1 million and \$4.3 million, respectively. Effective interest rate 5.578%.	255,703	253,054
1.50% Convertible Debentures due 2035, net of unamortized discount of \$40.1 million and \$42.5 million, respectively, and deferred issuance costs of \$1.4 million and \$1.5 million, respectively. Effective interest rate 5.394%.	222,340	219,875
Deferred issuance costs related to our Revolving Credit Facility	(1,091)	(1,174)
Total debt	2,299,594	2,617,404
Less: current portion	—	376,121
Total long-term debt	\$ 2,299,594	\$ 2,241,283

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

Fiscal Year	Convertible Debentures <sup>(1)</sup>	Senior Notes	Total
2018	\$ —	\$ —	\$ —
2019	—	—	—
2020	—	450,000	450,000
2021	—	—	—
2022	310,463	—	310,463
Thereafter	1,026,488	800,000	1,826,488
Total before unamortized discount	1,336,951	1,250,000	2,586,951



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

Less: unamortized discount and issuance costs	(277,455 )	(9,902 )	(287,357 )
Total long-term debt	\$ 1,059,496	\$ 1,240,098	\$ 2,299,594

Pursuant to the terms of each convertible instrument, holders have the right to redeem the debt on specific dates<sup>(1)</sup> prior to maturity. The repayment schedule above assumes that payment is due on the next redemption date after December 31, 2017.

11

---

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

5.625% Senior Notes due 2026

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

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

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

5.375% Senior Notes due 2020

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

In January 2017, we repurchased \$600.0 million in aggregate principal amount of our 2020 Senior Notes using cash and cash equivalents and the net proceeds from our 2026 Senior Notes issued in December 2016. In January 2017, we recorded an extinguishment loss of \$18.6 million. In accordance with the authoritative guidance for debt instruments, a loss on extinguishment is equal to the difference between the reacquisition price and the net carrying amount of the extinguished debt, including any unamortized debt discount or issuance costs. Following this activity, \$450.0 million in aggregate principal amount of our 2020 Senior Notes remains outstanding.

6.0% Senior Notes due 2024

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

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

## NUANCE COMMUNICATIONS, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

**1.0% Convertible Debentures due 2035**

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

**2.75% Convertible Debentures due 2031**

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

In June 2015, we entered into separate privately negotiated agreements with certain holders of our 2031 Debentures to exchange, in a private placement, \$256.2 million in aggregate principal amount of our 2031 Debentures for approximately \$263.9 million in aggregate principal amount of our 1.5% 2035 Debentures. In December 2015, we entered into separate privately negotiated agreements with certain holders of our 2031 Debentures to repurchase \$38.3 million in aggregate principal with proceeds received from the issuance of our 1.0% 2035 Debentures. In March 2017, we entered into separate privately negotiated agreements with certain holders of our 2031 Debentures to repurchase \$17.8 million in aggregate principal with proceeds received from the issuance of our 1.25% Senior Convertible Debentures issued in March 2017. Following these activities, \$377.7 million in aggregate principal amount of our 2031 Debentures remained outstanding as of September 30, 2017, which was included within the total current liabilities.

In November 2017, holders of approximately \$331.2 million in aggregate principal amount of the outstanding 2031 Debentures exercised their right to require us to repurchase such debentures. Following the repurchase, \$46.6 million in aggregate principal amount of the 2031 Debentures remains outstanding. On or after November 6, 2017, we have the right to call for redemption of some or all of the remaining outstanding 2031 Debentures.

**1.25% Convertible Debentures due 2025**

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

million and \$17.8 million in aggregate principal on our 2031 Debentures. We used the remaining net proceeds, together with cash on hand to redeem and retire \$331.2 million of our outstanding 2031 Debentures in November 2017. The 1.25% 2025 Debentures bear interest at 1.25% per year, payable in cash semi-annually in arrears, beginning on October 1, 2017. The 1.25% 2025 Debentures mature on April 1, 2025. The 1.25% 2025 Debentures are general senior unsecured obligations and rank equally in right of payment with all of our existing and future unsecured, unsubordinated indebtedness and senior in right of payment to any indebtedness that is contractually subordinated to the 1.25% 2025 Debentures. The 1.25% 2025 Debentures will be effectively subordinated to indebtedness and other liabilities of our subsidiaries.

## NUANCE COMMUNICATIONS, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

We account separately for the liability and equity components of the 1.25% 2025 Debentures in accordance with authoritative guidance for convertible debt instruments that may be settled in cash upon conversion. The guidance requires the carrying amount of the liability component to be estimated by measuring the fair value of a similar liability that does not have an associated conversion feature and record the remainder in stockholders' equity. At issuance, we allocated \$252.1 million to long-term debt, and \$97.9 million has been recorded as additional paid-in capital, which is being amortized to interest expense using the effective interest rate method through April 1, 2025. If converted, the principal amount of the 1.25% 2025 Debentures is payable in cash and any amounts payable in excess of the principal amount will (based on an initial conversion rate, which represents an initial conversion price of approximately \$22.22 per share, subject to adjustment under certain circumstances) be paid in cash or shares of our common stock, at our election, only in the following circumstances and to the following extent: (i) prior to October 1, 2024, on any date during any fiscal quarter beginning after June 30, 2017 (and only during such fiscal quarter) if the closing sale price of our common stock was more than 130% of the then current conversion price for at least 20 trading days in the period of the 30 consecutive trading days ending on the last trading day of the previous fiscal quarter; (ii) at any time on or after October 1, 2024, (iii) during the five consecutive business-day period immediately following any five consecutive trading-day period in which the trading price for \$1,000 principal amount of the 1.25% 2025 Debentures for each day during such five trading-day period was less than 98% of the closing sale price of our common stock multiplied by the then current conversion rate; or (iv) upon the occurrence of specified corporate transactions, as described in the indenture for the 1.25% 2025 Debentures. We may not redeem the 1.25% 2025 Debentures prior to the maturity date. If we undergo a fundamental change or non-stock change of control (as described in the indenture for the 1.25% 2025 Debentures) prior to maturity, holders will have the option to require us to repurchase all or any portion of their debentures for cash at a price equal to 100% of the principal amount of the 1.25% 2025 Debentures to be purchased plus any accrued and unpaid interest, including any additional interest to, but excluding, the repurchase date. As of December 31, 2017, none of the conversion criteria were met for the 1.25% 2025 Debentures. If the conversion criteria were met, we could be required to repay all or some of the aggregate principal amount in cash prior to the maturity date.

**1.50% Convertible Debentures due 2035**

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

**Revolving Credit Facility**

Our revolving credit agreement (the "Revolving Credit Facility"), which expires on April 15, 2021, provides for aggregate borrowing commitments of \$242.5 million, including the revolving facility loans, the swingline loans and issuance of letters of credit. As of December 31, 2017, after taking into account the outstanding letters of credit of \$4.5 million, we had \$238.0 million available for additional borrowing under the Revolving Credit Facility. The borrowing outstanding under the Revolving Credit Facility bears interest at either (i) LIBOR plus an applicable margin of 1.50% or 1.75%, or (ii) the alternative base rate plus an applicable margin of 0.50% or 0.75%. The

Revolving Credit Facility is secured by substantially all our assets. The Revolving Credit Facility contains customary affirmative and negative covenants and conditions to borrowing, as well as customary events of default. As of December 31, 2017, we are in compliance with all the debt covenants.

#### 11. Stockholders' Equity

##### Share Repurchases

On April 29, 2013, our Board of Directors approved a share repurchase program for up to \$500.0 million of our outstanding shares of common stock. On April 29, 2015, our Board of Directors approved an additional \$500.0 million under our share repurchase program. Under the terms of the share repurchase program, we have the ability to repurchase shares from time to time through a

## NUANCE COMMUNICATIONS, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

variety of methods, which may include open market purchases, privately negotiated transactions, block trades, accelerated stock repurchase transactions, or any combination of such methods. The share repurchase program does not require us to acquire any specific number of shares and may be modified, suspended, extended or terminated by us at any time without prior notice. The timing and the amount of any purchases will be determined by management based on an evaluation of market conditions, capital allocation alternatives, and other factors.

There were no share repurchases for the three months ended December 31, 2017 or 2016. Since the commencement of the program, we have repurchased an aggregate of 46.5 million shares for \$806.6 million. The amount paid in excess of par value is recognized in additional paid in capital. Shares were retired upon repurchase. As of December 31, 2017, approximately \$193.4 million remained available for future repurchases under the program.

## 12. Net Income (Loss) Per Share

The following table sets forth the computation for basic and diluted net income (loss) per share (dollars in thousands, except per share amounts):

	Three Months Ended December 31,	
	2017	2016
Numerator:		
Net income (loss)	\$53,228	\$(23,929)
Denominator:		
Weighted average common shares outstanding - Basic	291,367	288,953
Dilutive effect of employee stock compensation plans	4,628	—
Weighted average common shares outstanding — diluted	295,995	288,953
Net income (loss) per share:		
Basic	\$0.18	\$(0.08 )
Diluted	\$0.18	\$(0.08 )

For the three months ended December 31, 2017 and 2016, respectively, 0.1 million and 7.1 million shares of anti-dilutive equity instruments issued under our employee stock compensation plans were excluded from the computation of diluted net income (loss) per share. 2.2 million and 2.8 million shares of contingently issuable awards were excluded from the determination of diluted net income per share as the conditions were not met if the end of the reporting period would be the end of the performance period. For the three months ended December 31, 2016, there was no dilutive effect of equity instruments as the impact of these items was anti-dilutive due to the net loss incurred during the period.

## 13. Stock-Based Compensation

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

	Three Months Ended December 31,	
	2017	2016
Cost of professional services and hosting	\$7,407	\$8,410
Cost of product and licensing	266	92
Cost of maintenance and support	1,204	977
Research and development	9,696	8,490
Sales and marketing	10,676	11,969
General and administrative	8,737	9,192



Total \$37,986 \$39,130

15

---

## NUANCE COMMUNICATIONS, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## Stock Options

The table below summarizes activities related to stock options for the three months ended December 31, 2017:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value <sup>(a)</sup>
Outstanding at September 30, 2017	23,807	\$ 15.39		
Exercised	(1,859 )	\$ 3.41		
Outstanding at December 31, 2017	21,948	\$ 16.40	2.8 years	\$0.1 million
Exercisable at December 31, 2017	21,939	\$ 16.41	2.8 years	\$0.1 million
Exercisable at December 31, 2016	1,050,038	\$ 16.29	1.0 year	\$0.2 million

<sup>(a)</sup> The aggregate intrinsic value in this table represents any excess of the closing market price of our common stock as of December 31, 2017 (\$16.35) over the exercise price of the underlying options.

The aggregate intrinsic value of stock options exercised during the three months ended December 31, 2017 and 2016 was \$0.02 million and \$0.7 million, respectively.

## Restricted Units

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

	Number of Shares Underlying Restricted Units — Contingent Awards	Number of Shares Underlying Restricted Units — Time-Based Awards
Outstanding at September 30, 2017	5,043,931	6,477,164
Granted	688,999	4,263,946
Earned/released	(1,687,862 )	(3,614,185 )
Forfeited	(893,287 )	(168,642 )
Outstanding at December 31, 2017	3,151,781	6,958,283
Weighted average remaining recognition period of outstanding restricted units	1.2 years	1.8 years
Unrecognized stock-based compensation expense of outstanding restricted units	\$45.0 million	\$79.8 million
Aggregate intrinsic value of outstanding restricted units <sup>(a)</sup>	\$51.5 million	\$113.9 million

<sup>(a)</sup> The aggregate intrinsic value in this table represents any excess of the closing market price of our common stock as of December 31, 2017 (\$16.35) over the purchase price of the underlying restricted units.

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

Three Months  
Ended  
December 31,

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

	2017	2016
Weighted-average grant-date fair value per share	\$14.92	\$15.90
Total intrinsic value of shares vested (in millions)	\$84.7	\$88.3

16

---

## NUANCE COMMUNICATIONS, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## 14. Income Taxes

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

	Three Months Ended	
	December 31,	
	2017	2016
Domestic	\$(40,031)	\$(47,583)
Foreign	14,738	34,007
Loss before income taxes	\$(25,293)	\$(13,576)

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

	Three Months Ended	
	December 31,	
	2017	2016
Domestic	\$(80,866)	\$4,159
Foreign	2,345	6,194
(Benefit) provision for income taxes	\$(78,521)	\$10,353
Effective tax rate	310.4	% (76.3 )%

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was signed into law. The TCJA significantly revises the U.S. corporate income tax by, among other things, lowering corporate income tax rates, implementing a hybrid territorial tax system, and imposing a one-time repatriation tax on foreign cash and earnings.

We are currently assessing the impact of the realization of deferred tax assets, remeasurement of deferred taxes at lower rates, and the provision for a one-time repatriation tax. Based on our preliminary assessment, we recorded a provisional amount of income tax benefit for the three months ended December 31, 2017, reflecting a benefit of approximately \$96 million related to changes in the carrying value of certain deferred tax assets and liabilities, offset in part by an expense of approximately \$14 million related to deemed repatriation of foreign cash and earnings. The provisional amounts above were based upon the estimate of (i) temporary differences at the end of the upcoming tax year, (ii) the timing of the temporary differences expected to reverse, (iii) foreign earnings and profits, and (iv) foreign income taxes. The assessment is incomplete as of December 31, 2017. As our assessment is ongoing, these amounts may materially change as we revise our assumptions and estimates based on new information available to us, changes in our interpretations, additional guidance to be issued, and actions we may take as a result of the TCJA.

Additionally, we are still evaluating the full impact of other provisions of the TCJA, which may materially increase or decrease our income tax provision. The assessment is expected to be completed no later than the first quarter of fiscal year 2019.

## 15. Commitments and Contingencies

## Litigation and Other Claims

Similar to many companies in the software industry, we are involved in a variety of claims, demands, suits, investigations and proceedings that arise from time to time relating to matters incidental to the ordinary course of our business, including at times actions with respect to contracts, intellectual property, employment, benefits and securities matters. At each balance sheet date we evaluate contingent liabilities associated with these matters in accordance with ASC 450 "Contingencies." If the potential loss from any claim or legal proceeding is considered probable and the amount can be reasonably estimated, we accrue a liability for the estimated loss. Significant judgments are required for the determination of probability and the range of the outcomes, and estimates are based only on the best information available at the time. Due to the inherent uncertainties involved in claims and legal proceedings and in estimating losses that may arise, actual outcomes may differ from our estimates. Contingencies deemed not probable or for which losses were not estimable in one period may become probable, or losses may become estimable in later periods, which may have a material impact on our results of operations and financial position. As of December 31, 2017, accrued losses were not material to our condensed consolidated financial statements, and we do not expect any pending matter to have a material impact on our condensed consolidated

financial statements.

**Guarantees and Other**

We include indemnification provisions in the contracts we enter 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

17

---

## NUANCE COMMUNICATIONS, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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

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

#### 16. Segment and Geographic Information

During the first quarter of fiscal year 2018, we commenced a reorganization of our segment reporting structure based on the growth of each business and the evolving industry vertical in which it participates. Such reorganization will allow our Chief Operating Decision Maker ("CODM") greater focus on implementing strategic initiatives and identifying future investment opportunities. In January 2018, we publicly announced that, in addition to the previously communicated intent to establish the automotive business as a separate reportable segment and business line, we will also merge the Communications Service Provider (CSP, or Mobile Operator Services) business line into the Enterprise segment to form a consolidated focus on our business in the telecommunications market. In connection with the ongoing reorganization, we are currently implementing changes to our reporting processes to facilitate operating segment reporting. As a transition, during the first quarter of fiscal year 2018, segment information compiled and presented to our CODM still reflects the existing segment structure. As a result, segment information for the three months ended December 31, 2017 and 2016 below was presented in manner consistent with the level of discrete financial information included within our CODM review package. We expect that the reorganization efforts will be completed in the second quarter of fiscal year 2018, and the presentation of our segment information will reflect the reorganized segment reporting structure upon completion of the reorganization. Additionally, we are continuing the process of identifying and assessing other initiatives to better align our segment reporting structure with our long-term strategies.

Our CODM regularly reviewed segment revenues and segment profits for performance evaluation and resources allocation. Segment revenues include certain acquisition-related adjustments for revenues that would otherwise have been recognized without the acquisition. Segment profits reflect controllable costs directly related to each segment and the allocation of certain corporate expenses such as, corporate sales and marketing expenses and research and development project costs that benefit multiple segments. Certain items such as stock-based compensation, amortization of intangible assets, acquisition-related costs, net, restructuring and other charges, net, other expenses, net and certain unallocated corporate expenses are excluded from segment profits, which allow for more meaningful comparisons to the financial results of the historical operations for the performance evaluation and resources allocation by our CODM.

The Healthcare segment is primarily engaged in clinical speech and clinical language understanding solutions that improve the clinical documentation process, from capturing the complete patient record to improving clinical documentation and quality measures for reimbursement.

The Mobile segment is primarily engaged in providing a broad portfolio of specialized virtual assistants and connected services built on voice recognition, text-to-speech, natural language understanding, dialog, and text input technologies.

The Enterprise segment is primarily engaged in using speech, natural language understanding, and artificial intelligence to provide automated customer solutions and services for voice, mobile, web and messaging channels. The Imaging segment is primarily engaged in software solutions and expertise that help professionals and organizations to gain optimal control of their document and information processes through scanning and print management.

## NUANCE COMMUNICATIONS, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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

	Three Months Ended December 31,	
	2017	2016
Segment revenues:		
Healthcare	\$245,535	\$239,208
Mobile	89,829	91,784
Enterprise	117,831	112,938
Imaging	55,630	52,089
Total segment revenues	508,825	496,019
Less: acquisition-related revenues adjustments	(7,180 )	(8,361 )
Total revenues	501,645	487,658
Segment profit:		
Healthcare	77,419	78,567
Mobile	25,423	33,471
Enterprise	38,935	31,958
Imaging	15,643	17,616
Total segment profit	157,420	161,612
Corporate expenses and other, net	(44,665 )	(30,959 )
Acquisition-related revenues	(7,180 )	(8,361 )
Stock-based compensation	(37,986 )	(39,130 )
Amortization of intangible assets	(38,420 )	(43,401 )
Acquisition-related costs, net	(5,561 )	(9,026 )
Restructuring and other charges, net	(14,801 )	(6,703 )
Other expenses, net	(34,100 )	(37,608 )
Loss before income taxes	\$(25,293 )	\$(13,576 )

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

	Three Months Ended December 31,	
	2017	2016
United States	\$364,286	\$349,170
International	137,359	138,488
Total revenues	\$501,645	\$487,658



NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

17. Supplemental Cash Flow Information

Cash paid for Interest and Income Taxes:

Three Months  
Ended December  
31,  
2017 2016  
(Dollars in  
thousands)

Interest paid \$27,281 \$11,069

Income taxes paid \$4,600 \$4,205

Non-Cash Investing and Financing Activities:

From time to time, we issue shares of our common stock in connection with our business and asset acquisitions, including shares issued as payment for acquisitions, shares initially held in escrow, and shares issued as payment for contingent consideration, which is discussed in Note 3.

## Table of Contents

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

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

#### CAUTIONARY NOTE CONCERNING FORWARD-LOOKING STATEMENTS

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

- our future bookings, revenues, cost of revenues, research and development expenses, selling, general and administrative expenses, amortization of intangible assets and gross margin;

- our strategy relating to our segments;

- our transformation program to reduce costs and optimize processes;

- market trends;

- technological advancements;

- the potential of future product releases;

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

- future acquisitions, and anticipated benefits from acquisitions;

- international operations and localized versions of our products; and

- the conduct, timing and outcome of legal proceedings and litigation matters.

You can identify these and other forward-looking statements by the use of words such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "intends," "potential," "continue" or the negative of such terms, or other comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks described in Item 1A — "Risk Factors" and elsewhere in this Quarterly Report on Form 10-Q.

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

#### OVERVIEW

##### Business Overview

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

##### Business Trends

- **Healthcare.** Within our healthcare business, our customers are shifting away from solely using hosted transcription services towards more integrated solutions that combine both Dragon Medical cloud solutions and hosted

transcription services. The volume processed in our hosted transcription services has continued to decline as customers implement electronic medical record systems and our Dragon Medical solutions. This negative trend was partially offset by new customer wins and higher demands for integrated solutions. Additionally, customers continued to shift away from perpetual licenses towards hosting solutions, which enable the expansion of our Dragon Medical cloud solutions to include new clinical language understanding and Artificial Intelligence ("AI") innovations, providing real time queries to the physician at the point of care.

21

---

## Table of Contents

**Mobile.** Our Mobile segment continued to benefit from the increasing demands for specialized virtual assistants and connected car services built on voice recognition and natural language understanding as automotive manufacturers compete to incorporate specialized virtual assistants in their product offerings to deliver a more integrated and personalized driving experience. We continue to strengthen our position in the fast-growing connected car market by partnering with new customers and expanding our offerings to existing customers. The positive trend in automotive is offset in part by the negative effect of the consolidation of the mobile devices industry and the current headwinds in our Mobile Operator Services.

**Enterprise.** Strong demands for our omni-channel engagement solutions powered by AI continued to fuel revenue growth within our Enterprise segment. Additionally, the segment benefited from the strengths in our digital messaging solutions and our Engines and Analytics offers, along with solid performance in our professional services. We continued to enhance our technology capabilities with intelligent self-service and artificial intelligence for customer service, extend the market for our on-demand omni-channel enterprise solutions into international markets, expand our sales and solutions for biometrics, and expand our core products and services portfolio.

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

### Key Metrics

A summary of key financial metrics for the three months ended December 31, 2017, as compared to the three months ended December 31, 2016, is as follows:

- Total revenues increased by \$14.0 million to \$501.6 million;
- Net income increased by \$77.2 million to \$53.2 million;
- Gross margins decreased by 0.5 percentage points to 55.9%;
- Operating margins decreased by 3.2 percentage points to 1.8%; and
- Cash provided by operating activities decreased by \$38.8 million to \$86.1 million.

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

- Total deferred revenue increased by 9.7% from \$802.5 million to \$880.6 million primarily driven by continued growth of our automotive connected services.

A summary of key operating metrics for the three months ended December 31, 2017, as compared to the three months ended December 31, 2016, is as follows:

- Net new bookings increased by 10.0% from one year ago to \$418.4 million. The net new bookings growth was primarily driven by our automotive business and Enterprise solutions.

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

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

Recurring revenue represented 70.8% and 72.4% of total revenue for three months ended December 31, 2017 and December 31, 2016, respectively. Recurring revenue represents the sum of recurring hosting, product and licensing, and maintenance and support revenues as well as the portion of professional services revenue delivered under ongoing

contracts. Recurring product and licensing revenue comprises term-based and ratable licenses as well as revenues from royalty arrangements.

Table of Contents

Annualized line run-rate in our on-demand healthcare solutions decreased by 28% from a year ago to approximately 3.3 billion lines per year. The decrease was primarily due to the continued erosion in our transcription services and the impact of the malware incident that occurred in the third quarter of fiscal year 2017. The annualized line run-rate is determined using billed equivalent line counts in a given quarter, multiplied by four.

Estimated three-year value of total on-demand contracts at December 31, 2017 decreased by 6% from a year ago to approximately \$2.3 billion. The decrease was primarily due to the continued erosion in our transcription services and the impact of the malware incident, offset by growth in our Dragon Medical cloud and automotive solutions. We determine this value as of the end of the period reported, by using our estimate of three years of anticipated future revenue streams under signed on-demand contracts then in place, whether or not they are guaranteed through a minimum commitment clause. Our estimate is based on assumptions used in evaluating the contracts and determining sales compensation, adjusted for changes in estimated launch dates, actual volumes achieved, and other factors deemed relevant. For contracts with an expiration date beyond three years, we include only the value expected within three years. For other contracts, we assume renewal consistent with historic renewal rates unless there is a known cancellation. Contracts are 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.

**Cybersecurity & Data Privacy Matters**

On June 27, 2017, Nuance was a victim of the global NotPetya malware incident (the “Malware Incident”). The NotPetya malware affected certain Nuance systems, including systems used by our healthcare customers, primarily for transcription services, as well as systems used by our imaging division to receive and process orders. For fiscal year 2017, we estimate that we lost approximately \$68.0 million in revenues, primarily in our Healthcare segment, due to the service disruption and the reserves we established for customer refund credits related to the Malware Incident. Additionally, we incurred incremental costs of approximately \$24.0 million for fiscal year 2017 as a result of our remediation and restoration efforts, as well as incremental amortization expenses. Although the direct effects of the Malware Incident were remediated during fiscal year 2017, as explained below, the Malware Incident had a continued effect on our results of operations in the first quarter of fiscal year 2018 including contributing to: a year-over-year decline in the annualized line run-rate in our on-demand healthcare solutions and in the estimated three-year value of on-demand contracts; a year-over-year decline in hosted revenue and an increase in restructuring and other charges. In addition, we expect to expend additional resources during fiscal year 2018 and beyond to continue to enhance and upgrade information security.

In addition, in December 2017, an unauthorized third party illegally accessed reports hosted on a Nuance transcription platform. This incident was limited in scope to records of approximately 45,000 individuals and was isolated to a single transcription platform that was promptly shutdown. Customers using that platform were notified of the incident and were migrated to our eScripton transcription platforms. We also notified law enforcement authorities and have cooperated in their investigation into the matter. This incident did not have a material effect on our financial results for the first quarter of fiscal year 2018 and is not expected to have a material effect on our financial results for future periods. Future cybersecurity or data privacy incidents could have a material adverse effect on our results of operations. See “Risk Factors - Cybersecurity and data privacy incidents or breaches may damage client relations and inhibit our growth.”.

**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		Dollar Change	Percent Change	
	Ended				
	December 31, 2017	2016			
Professional services and hosting	\$259.0	\$253.4	\$5.6	2.2	%
Product and licensing	161.8	151.8	10.1	6.6	%

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

Maintenance and support	80.8	82.5	(1.7 )	(2.0 )%
Total Revenues	\$501.6	\$487.7	\$14.0	2.9 %
United States	\$364.3	\$349.2	\$15.1	4.3 %
International	137.4	138.5	(1.1 )	(0.8 )%
Total Revenues	\$501.6	\$487.7	\$14.0	2.9 %

The geographic split for the three months ended December 31, 2017, was 73% of total revenues in the United States and 27% internationally, as compared to 72% of total revenues in the United States and 28% internationally for the same period last year.

Table of Contents

## Professional Services and Hosting Revenue

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

	Three Months		Dollar Change	Percent Change
	Ended December 31, 2017	2016		
Professional services revenue	\$73.9	\$60.1	\$ 13.8	22.9 %
Hosting revenue	185.1	193.3	(8.1 )	(4.2 )%
Professional services and hosting revenue	\$259.0	\$253.4	\$ 5.6	2.2 %
As a percentage of total revenue	51.6 %	52.0 %		

Three Months Ended December 31, 2017 compared to Three Months Ended December 31, 2016

Hosting revenue decreased by \$8.1 million, or 4.2%. The decreases were primarily due to lower hosting revenue in our Healthcare segment due to the continued erosion in transcription services, and the negative impact of the Malware Incident, offset in part by the positive effect of customers' transition to our Dragon cloud-based solutions.

Professional services revenue increased by \$13.8 million, or 22.9%. The increases were primarily due to higher revenue from professional services related to Dragon Medical offerings in our Healthcare segment.

As a percentage of total revenue, professional services and hosting revenue decreased from 52.0% to 51.6%, primarily due to lower hosting revenue in our Healthcare segment discussed above.

## 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		Dollar Change	Percent Change
	Ended December 31, 2017	2016		
Product and licensing revenue	\$161.8	\$151.8	\$ 10.1	6.6 %
As a percentage of total revenue	32.3 %	31.1 %		

Three Months Ended December 31, 2017 compared to Three Months Ended December 31, 2016

Product and licensing revenue increased by \$10.1 million, or 6.6%. As a percentage of total revenue, product and licensing revenue increased from 31.1% to 32.3%. The increases were primarily due to higher product and licensing revenue in our Healthcare segment, primarily due to higher revenue from diagnostics solutions due to recent acquisitions and the growth in clinical documentation improvement solutions.

## 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		Dollar Change	Percent Change
	Ended December 31, 2017	2016		
Maintenance and support revenue	\$80.8	\$82.5	\$ (1.7 )	(2.0 )%
As a percentage of total revenue	16.1 %	16.9 %		

Three Months Ended December 31, 2017 compared to Three Months Ended December 31, 2016

Maintenance and support revenue decreased by \$1.7 million, or 2.0%. As a percentage of total revenue, maintenance and support revenue decreased from 16.9% to 16.1%. The decreases were primarily due to lower maintenance and support revenue in Healthcare as customers continued to transition from product licenses to cloud-based solutions.





Table of Contents**COSTS AND EXPENSES****Cost of Professional Services and Hosting Revenue**

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

	Three Months		Dollar Change	Percent Change
	Ended December 31, 2017	2016		
Cost of professional services and hosting revenue	\$172.5	\$164.9	\$ 7.6	4.6 %
As a percentage of professional services and hosting revenue	66.6 %	65.1 %		

Three Months Ended December 31, 2017 compared to Three Months Ended December 31, 2016

The increase in cost of professional services and hosting revenue was primarily due to the growth in our Dragon Medical offerings, offset in part by the decline in transcription services revenue. Gross margins decreased by 1.5 percentage points primarily due to the gross margin decline in our transcription services, and the increase in healthcare consulting service engagements that contributed lower margin, offset in part by a favorable shift in revenue mix towards higher margin Dragon Medical offerings from lower margin transcription services.

**Cost of Product and Licensing Revenue**

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

	Three Months		Dollar Change	Percent Change
	Ended December 31, 2017	2016		
Cost of product and licensing revenue	\$19.1	\$18.4	\$ 0.7	3.8 %
As a percentage of product and licensing revenue	11.8 %	12.1 %		

Three Months Ended December 31, 2017 compared to Three Months Ended December 31, 2016

Cost of product and licensing revenue increased by \$0.7 million, or 3.8%. Gross margins increased 0.3 percentage points, primarily driven by margin improvement in Dragon Medical perpetual licenses due to growth in international markets.

**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 the cost of maintenance and support revenue, in dollars and as a percentage of maintenance and support revenue (dollars in millions):

	Three Months		Dollar Change	Percent Change
	Ended December 31, 2017	2016		
Cost of maintenance and support revenue	\$14.2	\$13.6	\$ 0.6	4.7 %
As a percentage of maintenance and support revenue	17.6 %	16.5 %		

Three Months Ended December 31, 2017 compared to Three Months Ended December 31, 2016

Cost of maintenance and support revenue increased by \$0.6 million, or 4.7%, primarily due to lower maintenance and support revenue. Gross margins decreased by 1.1 percentage points primarily due to lower margin on Dragon Medical maintenance and support services.

Table of Contents

## Research and Development Expense

Research and development ("R&D") 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		Dollar Change	Percent Change
	Ended December 31, 2017	2016		
Research and development expense	\$73.4	\$66.3	\$ 7.0	10.6 %
As a percentage of total revenue	14.6 %	13.6 %		

Three Months Ended December 31, 2017 compared to Three Months Ended December 31, 2016

Research and development expense increased by \$7.0 million, or 10.6%, primarily due to higher compensation expenses as a result of higher R&D headcount as we continue to enhance our R&D capability and invest in new technologies while optimizing our cost structure by shifting certain R&D activities to lower cost regions.

## 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		Dollar Change	Percent Change
	Ended December 31, 2017	2016		
Sales and marketing expense	\$102.0	\$101.5	\$ 0.4	0.4 %
As a percentage of total revenue	20.3 %	20.8 %		

Three Months Ended December 31, 2017 compared to Three Months Ended December 31, 2016

Sales and marketing expense increased by \$0.4 million, or essentially flat, as the increase in travel and entertainment expenses were offset by the lower compensation expense.

## General and Administrative Expense

General and administrative expense primarily consists of personnel costs for administration, finance, human resources, 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		Dollar Change	Percent Change
	Ended December 31, 2017	2016		
General and administrative expense	\$52.9	\$39.8	\$ 13.1	32.9 %
As a percentage of total revenue	10.5 %	8.2 %		

Three Months Ended December 31, 2017 compared to Three Months Ended December 31, 2016

General and administrative expense increased by \$13.1 million, or 32.9%, primarily due to higher professional fees related to identifying and evaluating strategic initiatives, higher expenses related to upgrading our technological infrastructure, and higher compensation expense related to increased administrative headcount.

Table of Contents

## Amortization of Intangible Assets

Amortization of acquired patents and technologies 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		Dollar Change	Percent Change
	Ended December 31, 2017	2016		
Cost of revenue	\$15.4	\$15.5	\$ (0.2 )	(1.2 )%
Operating expenses	23.1	27.9	(4.8 )	(17.2)%
Total amortization expense	\$38.4	\$43.4	\$ (5.0 )	(11.5)%
As a percentage of total revenue	7.7 %	8.9 %		

The decrease in total amortization of intangible assets for the three months ended December 31, 2017, as compared to the three months ended December 31, 2016, is primarily due to certain intangible assets which became fully amortized during fiscal year 2017.

## Acquisition-Related Costs, Net

Acquisition-related costs include costs related to business acquisitions. These costs consist of (i) transition and integration costs, including retention payments, transitional employee costs, earn-out payments, and other costs related to integration activities; (ii) professional service fees, including financial advisory, legal, accounting, and other outside services incurred in connection with acquisition activities, and disputes and regulatory matters related to acquired entities; and (iii) fair value adjustments to acquisition-related contingencies. A summary of the acquisition-related costs is as follows (dollars in millions):

	Three Months		Dollar Change	Percent Change
	Ended December 31, 2017	2016		
Transition and integration costs	\$4.1	\$3.7	\$ 0.4	9.5 %
Professional service fees	0.5	5.0	(4.5 )	(89.8)%
Acquisition-related adjustments	1.0	0.3	0.7	230.4 %
Total acquisition-related costs, net	\$5.6	\$9.0	\$ (3.5 )	(38.4)%
As a percentage of total revenue	1.1 %	1.9 %		

Acquisition-related costs, net for the three months ended December 31, 2017 decreased by \$3.5 million, primarily due to the decrease in professional services fees driven by reduced acquisition activities in the first quarter of fiscal year 2018.

## Restructuring and Other Charges, Net

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

	Three Months Ended December 31,				2016					
	2017		Total Restructuring	Other Charges	Total	Personnel Facilities		Total Restructuring	Other Charges	Total
Healthcare	\$2,513	\$ 25	\$ 2,538	\$ —	\$2,538	\$1,984	\$ 277	\$ 2,261	\$ —	\$2,261
Mobile	400	11	411	—	411	213	—	213	—	213
Enterprise	262	2,360	2,622	—	2,622	424	607	1,031	—	1,031
Imaging	1,223	9	1,232	—	1,232	361	351	712	—	712
Corporate	485	(740 )	(255 )	8,253	7,998	669	664	1,333	1,153	2,486

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

Total	\$4,883	\$1,665	\$6,548	\$8,253	\$14,801	\$3,651	\$1,899	\$5,550	\$1,153	\$6,703
-------	---------	---------	---------	---------	----------	---------	---------	---------	---------	---------

Fiscal Year 2018

During the three months ended December 31, 2017, we recorded restructuring charges of \$6.5 million, which included \$4.9 million related to the termination of approximately 160 employees and \$1.7 million related to certain excess facilities. These actions were

27

---

Table of Contents

part of our initiatives to reduce costs and optimize processes. We expect the remaining outstanding severance of \$1.0 million to be substantially paid during fiscal year 2018, and the remaining balance of \$8.8 million related to excess facilities to be paid through fiscal year 2025, in accordance with the terms of the applicable leases.

Additionally, during the three months ended December 31, 2017, we recorded \$2.3 million related to the transition agreement of our CEO, and \$6.0 million related to our remediation and restoration efforts after the malware incident that occurred in the third quarter of fiscal year 2017. The cash payments associated with the transition agreement are expected to be made during fiscal years 2018 and 2019.

**Fiscal Year 2017**

During the three months ended December 31, 2016, we recorded restructuring charges of \$5.6 million. The restructuring charges for the three months ended December 31, 2016 included \$3.7 million related to the termination of approximately 90 employees and \$1.9 million related to certain excess facilities. These actions were part of our initiatives to reduce costs and optimize processes. The restructuring charges also included \$1.9 million related to excess facilities. In addition, during the three months ended December 31, 2016, we recorded \$1.2 million related to the transition agreement of our CEO.

**Other Expense, Net**

A summary of other expenses, net is as follows (dollars in millions):

	Three Months		Dollar Change	Percent Change
	Ended December 31, 2017	2016		
Interest income	\$2.2	\$1.0	\$ 1.2	114.3 %
Interest expense	(36.1 )	(38.0 )	2.0	(5.1 )%
Other expense, net	(0.2 )	(0.6 )	0.4	(63.6 )%
Total other expense, net	\$(34.1)	\$(37.6)	\$ 3.5	(9.3 )%
As a percentage of total revenue	6.8 %	7.7 %		

Interest expense for the three months ended December 31, 2017 decreased \$2.0 million, as compared to three months ended December 31, 2016, was mainly due to the repurchase of \$600.0 million in aggregate principal amount of our 2020 Senior Notes in January 2017. The decrease was partially offset by the issuance of \$500.0 million 5.625% Senior Notes in the December 2016, the net proceeds of which were used for a portion of that repurchase.

**Provision for Income Taxes**

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

	Three Months		Dollar Change	Percent Change
	Ended December 31, 2017	2016		
(Benefit) provision for income taxes	\$(78.5)	\$10.4	\$(88.9)	(858.4)%
Effective income tax rate	310.4 %	(76.3 )%		

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was signed into law. The TCJA significantly revises the U.S. corporate income tax by, among other things, lowering corporate income tax rates, implementing a hybrid territorial tax system, and imposing a one-time repatriation tax on foreign cash and earnings.

We are currently assessing the impact of the realization of deferred tax assets, remeasurement of deferred taxes at lower rates, and a provision for the one-time repatriation tax. Based on our preliminary assessment, we recorded a provisional amount of income tax benefit for the three months ended December 31, 2017, reflecting a benefit of approximately \$96 million related to changes in carrying value of certain deferred tax assets and liabilities, offset in part by an expense of approximately \$14 million related to deemed repatriation of foreign cash and earnings. The provisional amounts above were based on the estimate of (i) temporary differences at the end of the upcoming tax

year, (ii) the timing of the temporary differences expected to reverse, (iii) foreign earnings and profits, and (iv) foreign taxes. The assessment is incomplete as of December 31, 2017. As our assessment is ongoing, these amounts may materially change as we revise our assumptions and estimates based on new information available to us, changes in our interpretations, additional guidance to be issued, and actions we may take as a result of the TCJA.

Additionally, we are still evaluating the full impact of other provisions of the TCJA, which may materially increase or decrease our income tax provision. The assessment is expected to be completed no later than the first quarter of fiscal year 2019.

Table of Contents

## SEGMENT ANALYSIS

During the first quarter of fiscal year 2018, we commenced a reorganization of our segment reporting structure based on the growth of each business and the evolving industry vertical in which it participates. Such reorganization will allow our Chief Operating Decision Maker ("CODM") greater focus on implementing strategic initiatives and identifying future investment opportunities. In January 2018, we publicly announced that, in addition to the previously communicated intent to establish the automotive business as a separate reportable segment and business line, we will also merge the Communications Service Provider (CSP, or Mobile Operator Services) business line into the Enterprise segment to form a consolidated focus on our business in the telecommunications market. In connection with the ongoing reorganization, we are currently implementing changes to our reporting processes to facilitate operating segment reporting. As a transition, during the first quarter of fiscal year 2018, segment information compiled and presented to our CODM still reflects the existing segment structure. As a result, segment information for the three months ended December 31, 2017 and 2016 below was presented in manner consistent with the level of discrete financial information included within our CODM review package. We expect that the reorganization efforts will be completed in the second quarter of fiscal year 2018, and the presentation of our segment information will reflect the reorganized segment reporting structure upon completion of the reorganization. Additionally, we are continuing the process of identifying and assessing other initiatives to better align our segment reporting structure with our long-term strategies.

The following table presents certain financial information about our operating segments (dollars in millions):

	Three Months Ended		Change	Percent Change	
	December 31, 2017	December 31, 2016			
Segment Revenues <sup>(a)</sup> :					
Healthcare	\$245.5	\$239.2	\$6.3	2.6	%
Mobile	89.8	91.8	(2.0)	(2.1)	%
Enterprise	117.8	112.9	4.9	4.3	%
Imaging	55.6	52.1	3.5	6.8	%
Total segment revenues	\$508.8	\$496.0	\$12.8	2.6	%
Less: acquisition related revenues adjustments	(7.2)	(8.4)	1.2	(14.1)	%
Total revenues	\$501.6	\$487.7	\$13.9	2.9	%
Segment Profit:					
Healthcare	\$77.4	\$78.6	\$(1.2)	(1.5)	%
Mobile	25.4	33.5	(8.1)	(24.0)	%
Enterprise	38.9	32.0	6.9	21.8	%
Imaging	15.6	17.6	(2.0)	(11.2)	%
Total segment profit	\$157.4	\$161.6	\$(4.2)	(2.6)	%
Segment Profit Margin					
Healthcare	31.5	% 32.8	% (1.3)		
Mobile	28.3	% 36.5	% (8.2)		
Enterprise	33.0	% 28.3	% 4.7		
Imaging	28.1	% 33.8	% (5.7)		
Total segment profit margin	30.9	% 32.6	% (1.6)		

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.

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

Segment Revenues

Three Months Ended December 31, 2017 compared to Three Months Ended December 31, 2016



Healthcare segment revenue increased by \$6.3 million, or 2.6%, primarily due to higher revenue from Dragon Medical offerings and diagnostic solutions, offset by in part by lower revenue from our transcription services revenue due to the continued erosion, and the negative impact of the Malware Incident.

Mobile segment revenue decreased by \$2.0 million, or 2.1%, primarily as higher revenue from our automotive solutions was more than offset by lower revenues from Mobile Operator Services and devices. Revenue from automotive solutions increased by \$2.6 million driven by the increasing demand for a more integrated and personalized driving experience. Revenue from

## Table of Contents

Mobile Operator Services decreased by \$2.4 million primarily due to slower-than-expected penetration in international markets. Devices revenue decreased by \$2.2 million primarily driven by the continued decline driven by consolidation of the mobile devices industry.

Enterprise segment revenue increased by \$4.9 million, or 4.3%, primarily due to higher revenue from our omni-channel offerings and continued strength in our on-premise portfolios, which reflected the increase in use of mobile applications and websites for customer relationship management, offset in part by the decrease in our on-demand solutions.

Imaging segment revenues increased by \$3.5 million, or 6.8%, primarily due to higher product and licensing revenue from our print management solutions.

### Segment Profit

Three Months Ended December 31, 2017 compared to Three Months Ended December 31, 2016

Healthcare segment profit decreased by \$1.2 million, or 1.5%, as the increase in segment revenue was more than offset by the effect of lower gross margin, which reflected the continued erosion of the transcription services and certain professional services arrangements that carried lower margin, offset in part by the positive effect of customers' transition to higher margin Dragon Medical cloud-based solutions. Segment profit margin decreased by 1.3 percentage points to 31.5% as the effect of lower gross margin was offset in part by lower operating expenses margin, which reflected essentially flat operating expenses on higher revenue for the current period.

Mobile segment profit decreased by \$8.1 million, or 24.0%, primarily due to declines in segment revenue and gross margin, and higher R&D expenses. Gross margin decline was primarily driven by our investment in automotive technologies and increased headcount for future business needs. Higher R&D expenses was primarily driven by our increased investment in new technologies to support future growth. Segment profit margin decreased by 8.2 percentage points to 28.3% primarily due to lower gross margin and higher operating expenses margin, driven by higher R&D expenses for the current period.

Enterprise segment profit increased by \$6.9 million, or 21.8%, primarily due to higher segment revenue and gross margin and lower operating expenses. Higher gross margin was primarily driven by margin expansion in our omni-channel offerings. Total operating expenses decreased as higher R&D expenses was more than offset by lower commission expense due to change in commission structure in the current period. Segment profit margin increased by 4.7 percentage points to 33.0%, due to higher gross margin and lower operating expenses margin.

Imaging segment profit decreased by \$2.0 million, or 11.2%, as increases in segment revenue and gross margin were more than offset by higher sales and marketing expenses. Gross margin benefited from a favorable shift in revenue mix towards higher margin licensing revenue from lower margin product revenue. Sales and marketing expenses increased primarily due to higher compensation expenses as the segment ramped up its sales and marketing capacity. Segment profit margin decreased by 5.7 percentage points to 28.1% as the gross margin improvement was more than offset by higher operating expenses margin.

## LIQUIDITY AND CAPITAL RESOURCES

### Liquidity

We had cash and cash equivalents and marketable securities of \$552.6 million as of December 31, 2017, a decrease of \$321.5 million from \$874.1 million as of September 30, 2017. Our working capital, as defined by total current assets less total current liabilities, was \$329.3 million as of December 31, 2017, compared to \$216.4 million as of September 30, 2017. Additionally, we had availability of \$238.0 million under our revolving credit facility as of December 31, 2017. We believe that our existing sources of liquidity are sufficient to support our operating needs, capital requirements and any debt service requirements for the next twelve months.

Cash and cash equivalents and marketable securities held by our international operations totaled \$174.1 million and \$148.6 million, respectively, as of December 31, 2017 and September 30, 2017. As more fully described in Note 14 to the accompanying condensed consolidated financial statement, as a result of the enactment of the Tax Cuts and Jobs Act ("TCJA"), we recorded a provisional amount of one-time repatriation tax of approximately \$14 million on foreign cash and earnings. The actual impact of the TCJA may differ materially from our estimate due to changes in our

interpretations and assumptions, additional guidance to be issued, and actions we may take as a result of the TCJA. In connection with the assessment of the impact of the TCJA, we are currently evaluating our indefinite reinvestment assertion

30

---

## Table of Contents

related to foreign cash and earnings.

### Cash Provided by Operating Activities

Cash provided by operating activities for the three months ended December 31, 2017, was \$86.1 million, a decrease of \$38.8 million from cash provided by operating activities of \$124.9 million for the three months ended December 31, 2016. The net decrease was primarily due to:

▲ a decrease of \$27.8 million due to lower net income, excluding non-cash adjustments;

▲ a decrease of \$23.0 million due to unfavorable changes in working capital, primarily due to the timing of billing and cash payments; and

Partially offset by an increase of \$12.0 million from changes in deferred revenue. Deferred revenue had a positive effect of \$87.9 million on operating cash flows for the three months ended December 31, 2017, as compared to \$75.9 million for the three months ended December 31, 2016, primarily driven by continued growth of our automotive connected services.

### Cash Provided by Investing Activities

Cash provided by investing activities for the three months ended December 31, 2017, was \$106.2 million, an increase of \$203.2 million from cash used in investing activities of \$97.0 million for the three months ended December 31, 2016. The net increase was primarily due to:

▲ An increase of \$149.7 million from the sale of marketable securities and other investments;

▲ a decrease of \$14.3 million for business and asset acquisitions; and

▲ a decrease of \$40.4 million for purchases of marketable securities and other investments.

### Cash Used in Financing Activities

Cash used in financing activities for the three months ended December 31, 2017, was \$386.7 million, an increase of \$841.3 million from cash provided by financing activities of \$454.6 million for the three months ended December 31, 2016. The net increase was primarily due to:

An increase of \$331.2 million from the redemption of our 2.75% Convertible Debentures due 2031 during the three months ended December 31, 2017. In November 2017, holders of approximately \$331.2 million in aggregate principal amount of the outstanding 2031 Debentures exercised their right to require us to repurchase such debentures;

▲ a decrease of \$495.0 million from new debt issuance. During the three months ended December 31, 2016, the net cash inflows from debt activities was \$495.0 million from the issuance of 5.625% Senior Notes due 2026;

▲ An increase of \$16.9 million related to acquisition payments with extended payment terms; and

Partially offset by a decrease of \$1.7 million as a result of lower cash payments required to net share settle employee equity awards, due to a decrease in vesting value as a result of lower stock prices during the three months ended December 31, 2017 as compared to the same period in the prior year.

## Debt

For a detailed description of the terms and restrictions of the debt and revolving credit facility, see Note 10 to the accompanying condensed consolidated financial statements.

### Share Repurchase Program

On April 29, 2013, our Board of Directors approved a share repurchase program for up to \$500.0 million of our outstanding shares of common stock. On April 29, 2015, our Board of Directors approved an additional \$500.0 million under our share repurchase program. Under the terms of the share repurchase program, we have the ability to repurchase shares from time to time through a variety of methods, which may include open market purchases, privately negotiated transactions, block trades, accelerated stock repurchase transactions, or any combination of such methods. The share repurchase program does not require us to acquire any specific number of shares and may be modified, suspended, extended or terminated by us at any time without prior notice. The timing and the amount of any purchases will be determined by management based on an evaluation of market conditions, capital allocation alternatives, and other factors.

There were no share repurchases for the three months ended December 31, 2017 or 2016. Since the commencement of the program, we have repurchased an aggregate of 46.5 million shares for \$806.6 million. The amount paid in excess of par value is recognized



Table of Contents

in additional paid in capital. Shares were retired upon repurchase. As of December 31, 2017, approximately \$193.4 million remained available for future repurchases under the program.

## Off-Balance Sheet Arrangements, Contractual Obligations

## Contractual Obligations

The following table outlines our contractual payment obligations (dollars in millions):

Contractual Obligations	Total	Contractual Payments Due in Fiscal Year			
		2018	2019 and 2020	2021 and 2022	Thereafter
Convertible debentures <sup>(1)</sup>	\$1,337.0	\$—	\$—	\$310.5	\$1,026.5
Senior notes	1,250.0	—	450.0	—	800.0
Interest payable on long-term debt <sup>(2)</sup>	539.4	64.5	173.4	122.4	179.1
Letters of credit <sup>(3)</sup>	4.5	4.4	0.1	—	—
Lease obligations and other liabilities:					
Operating leases	168.9	26.3	39.1	27.5	76.0
Operating leases under restructuring <sup>(4)</sup>	64.6	7.9	17.0	15.2	24.5
Purchase commitments <sup>(5)</sup>	31.1	6.5	13.8	10.8	—
Total contractual cash obligations	\$3,395.5	\$109.6	\$693.4	\$486.4	\$2,106.1

Pursuant to the terms of each convertible instrument, holders have the right to redeem the debt on specific dates (1) prior to maturity. The repayment schedule above assumes that payment is due on the next redemption date after December 31, 2017.

Interest per annum is due and payable semi-annually, and is determined based on the outstanding principal as of (2) December 31, 2017, the stated interest rate of each debt instrument and the assumed redemption dates discussed above.

(3) Letters of Credit are in place primarily to secure future operating lease payments.

Obligations include contractual lease commitments related to facilities that were part of restructuring plans. As of (4) December 31, 2017, we have subleased certain of the facilities with total sublease income of \$55.3 million through fiscal year 2025.

Purchase commitments include non-cancelable purchase commitments for property and equipment, inventory, and (5) services in the normal course of business. These amounts also include arrangements that require a minimum purchase commitment by us.

The gross liability for unrecognized tax benefits as of December 31, 2017 was \$31.2 million. We do not expect a significant change in the amount of unrecognized tax benefits within the next twelve months.

## Contingent Liabilities and Commitments

Certain acquisition payments to selling shareholders were contingent upon the achievement of pre-determined performance target over a period of time after the acquisition. Such contingent payments were recorded at estimated fair values upon the acquisition and re-measured in subsequent reporting periods. As of December 31, 2017, the maximum amount of payments to be made based on the agreements was \$25.1 million if the specific performance objectives are achieved. In addition, certain deferred compensation payments to selling shareholders contingent upon their continued employment after the acquisition was recorded as compensation expense over the requisite service period. As of December 31, 2017, total deferred compensation to be paid out upon the conclusion of requisite service periods was \$28.0 million.

## Off-Balance Sheet Arrangements

As of December 31, 2017, there were no off-balance sheet arrangements that may have a material impact on the condensed consolidated financial statements.

## CRITICAL ACCOUNTING POLICIES

Our critical accounting policies are described in Note 2 to the audited consolidated financial statements included in the “Critical Accounting Policies” section of “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in the Form 10-K for fiscal 2017.

**RECENTLY ADOPTED AND ISSUED ACCOUNTING STANDARDS**

See Note 3 to the accompanying condensed consolidated financial statements for a discussion of the recently adopted and issued accounting standards.

## Table of Contents

### 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 local functional currency, will be reported in the functional currency at the applicable exchange rate in effect at the time of the transaction. A change in the value of the functional currency compared to the foreign currency of the transaction will have either a positive or negative impact on our financial position and results of operations.

Assets and liabilities of our foreign entities 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 applicable period. Therefore, the change in the value of the U.S. dollar compared to foreign currencies may impact our financial position and results of operations. Historically, our primary exposure has related to transactions denominated in the euro, British pound, Brazilian real, Canadian dollar, Japanese yen, Indian rupee and Hungarian forint. We do not expect a 10% hypothetical change in foreign currency exchange rates as of December 31, 2017 to have a material impact on our financial condition, results of operations or cash flows.

Periodically, we enter into forward exchange contracts to hedge against foreign exchange rate fluctuations. Currently, we have not designated any contracts as fair value or cash flow hedges. The contracts are not designated as cash flow hedges and generally are for periods less than 90 days. As of December 31, 2017, the notional contract amount of outstanding foreign currency exchange contracts was \$82.4 million. 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 cash and cash equivalents and marketable securities.

At December 31, 2017, we held approximately \$552.6 million of cash and cash equivalents and marketable securities primarily consisting of cash, money-market funds, bank deposits and a separately managed investment portfolio.

Assuming a one percentage point change in interest rates, our interest income on our investments classified as cash and cash equivalents and marketable securities would change by approximately \$5.5 million per annum, based on the December 31, 2017 reported balances of our investment accounts.

At December 31, 2017, we had no outstanding debt exposed to variable interest rates.

#### Convertible Debentures

The fair values of our convertible debentures are dependent on the price and volatility of our common stock as well as movements in interest rates. The fair market values of these debentures will generally increase as the market price of our common stock increases and will decrease as the market price of our common stock decreases. The fair market values of these 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 values of these debentures, but do not impact our financial position, results of operations or cash flows 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 these 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, 2017 was \$45.8 million for the 2031 Debentures, based on an average of the bid and ask prices on that day. The conversion value on December 31, 2017 was approximately \$23.6 million. A 10% increase in the stock price over the December 31, 2017 closing price of \$16.35 would cause an estimated \$0.4 million increase to the fair value and a \$2.4 million increase to the conversion value of the debentures. The fair value at December 31, 2017 was \$273.0 million for the 1.5% 2035 Debentures, based on an average of the bid and ask prices on that day. The conversion value on December 31, 2017 was approximately \$185.5 million. A 10% increase in the stock price over the December 31, 2017 closing price of \$16.35 would cause an



estimated \$4.5 million increase to the fair value and a \$18.6 million increase to the conversion value of the debentures. The fair value at December 31, 2017 was \$648.2 million for the 1.0% 2035 Debentures, based on an average of the bid and ask prices on that day. The conversion value on December 31, 2017 was approximately \$406.3 million. A 10% increase in the stock price over the December 31, 2017 closing price of \$16.35 would cause an estimated \$31.7 million increase to the fair value and a \$40.6 million increase to the conversion value of the debentures. The fair value at December 31, 2017 was \$359.3 million for the 1.25% 2025 Debentures, based on an average of the bid and ask prices on that day. The conversion value on December 31, 2017 was approximately \$258.0 million. A 10% increase in the stock price over the December 31, 2017

## Table of Contents

closing price of \$16.35 would cause an estimated \$12.9 million increase to the fair value and a \$25.8 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 Rules 13a-15(e) and 15d-15(e) 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 Rules 13a-15(f) and 15d-15(f) under the Exchange Act.

#### Changes in Internal Control Over Financial Reporting

There were no material changes to our internal controls over financial reporting as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f) identified in connection with the evaluation 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 15, 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 below actually occurs, our business, financial condition or our results of operations could be seriously harmed. If that happens, the trading price of our common stock could decline, and you may lose part or all of the value of any of our shares held by you.

### Risks Related to Our Business

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 markets for our products and services are characterized by intense competition, evolving industry standards, emerging business and distribution models, disruptive software and hardware technology developments, short product and service life cycles, price sensitivity on the part of customers, and frequent new product introductions, including alternatives with limited functionality available at lower costs or free of charge. Within voice recognition and natural language understanding, we compete primarily with Amazon, Google, iFlyTek and other smaller providers. Within healthcare, we compete primarily with M\*Modal, Optum, 3M and other smaller providers. Within imaging, we compete primarily with ABBYY and Adobe. In our enterprise business, some of our partners such as Avaya, Cisco, and Genesys develop and market products that might be considered substitutes for our solutions. In addition, a number

of smaller companies in voice recognition, natural language understanding, text input 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. Furthermore, there has been a trend toward industry consolidation in our markets for several years. We expect this trend to continue as companies attempt to strengthen or hold their market positions in an evolving industry and as companies are acquired or are unable to continue operations.

Table of Contents

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, Amazon and Google, have significantly greater financial, technical and marketing resources than we do. These competitors may be able to respond more rapidly than we can to new or emerging technologies or changes in customer requirements. They may also devote greater resources to the development, promotion and sale of their products than we do, and in certain cases may be able to include or combine their competitive products or technologies with other of their products or technologies in a manner whereby the competitive functionality is available at lower cost or free of charge within the larger offering. 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.

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 these fluctuations, 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. These fluctuations may cause our results of operations to not meet the expectations of securities analysts or investors. If this occurs, the price of our stock would likely decline. Factors that contribute to fluctuations in operating results include:

- volume, timing and fulfillment of customer orders and receipt of royalty reports;
- the pace of the transition to an on-demand and transactional revenue model;
- slowing sales by our channel partners to their customers;
- customers delaying their purchasing decisions in anticipation of new versions of our products;
- contractual counterparties are unable to, or do not, meet their contractual commitments to us;
- 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 of goodwill or intangible assets;
- delayed realization of synergies resulting from our acquisitions;
- cybersecurity or data breaches perpetrated by hackers or other third parties;
- accounts receivable that are not collectible and write-offs of excess or obsolete inventory;
- 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.

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, foreign currency fluctuations 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 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 the United Kingdom that provide professional services. A significant portion of the development of our voice recognition and natural language understanding solutions is conducted in Canada and Germany, and a significant portion of our imaging research and development is conducted in Hungary and Canada. We also have significant research and development resources in Austria, Belgium, China, Italy, and the United Kingdom. In addition, we are exposed to changes in foreign currencies including the euro, British pound, Brazilian real, Canadian dollar, Japanese yen, Indian rupee and Hungarian forint. Changes in

Table of Contents

the value of foreign currencies relative to the value of the U.S. dollar could adversely affect future revenue and operating results. Accordingly, our future results could be harmed by a variety of factors associated with international sales and operations, including:

- the impact on local and global economies of the United Kingdom leaving the European Union;
- changes in foreign currency exchange rates or the lack of ability to hedge certain foreign currencies;
- changes in a specific country's or region's economic conditions;
- compliance with laws and regulations in many countries and any subsequent changes in such laws and regulations;
- geopolitical turmoil, including terrorism and war;
- trade protection measures and import or export licensing requirements imposed by the United States and/or by other countries;
- restrictions on cross-border investment, including enhanced oversight by the Committee on Foreign Investment in the United States (CFIUS);
- changes in applicable tax laws;
- difficulties in staffing and managing operations in multiple locations in many countries;
- longer payment cycles of foreign customers and timing of collections in foreign jurisdictions; and
- less effective protection of intellectual property than in the United States.

We are currently involved in a search for a new Chief Executive Officer. If this search is delayed or we encounter difficulties in the transition, our business could be negatively impacted.

On January 22, 2018, as previously disclosed, we confirmed the forthcoming retirement of Paul Ricci as our Chief Executive Officer on or before March 31, 2018. Our Board of Directors engaged a nationally recognized search firm in 2017 to assist it with its search for a new CEO and is conducting a Chief Executive Officer search process to identify and evaluate candidates to succeed Mr. Ricci as Chief Executive Officer. There are no assurances concerning the timing or outcome of our search for a new Chief Executive Officer. If there are any delays in this process, or if any transition is not successful, our business could be negatively impacted.

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 research and development 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.

We experienced a significant malware incident in the third quarter of fiscal 2017, which has a significant impact on our future results of operations and financial condition.

On June 27, 2017, Nuance was a victim of the global NotPetya malware incident (the "Malware Incident"). The NotPetya malware affected certain Nuance systems, including systems used by our healthcare customers, primarily for transcription services, as well as systems used by our imaging division to receive and process orders. Our revenue and our operating results for fiscal year 2017 were negatively impacted by the aforementioned Malware Incident. For fiscal year 2017, we estimate that we lost approximately \$68.0 million in revenues, primarily in our Healthcare segment, due to the service disruption and the reserves we established for customer refund credits. Additionally, we incurred incremental costs of approximately \$24.0 million for fiscal year 2017 as a result of our remediation and restoration efforts, as well as incremental amortization expenses. Although the direct effects of the Malware Incident were remediated during fiscal year 2017, the Malware Incident had a continued effect on our results of operations in the first quarter of fiscal year 2018 and our outlook for the remainder of fiscal year 2018 and beyond reflects both the residual effects of the incident and the additional resources we will need to invest on an ongoing basis to continuously enhance information security.

Cybersecurity and data privacy incidents or breaches may damage client relations and inhibit our growth. The confidentiality and security of our information, and that of third parties, is critical to our business. Our services involve the transmission, use, and storage of customers' and their customer's confidential information. We were the victim of a cybercrime in the past, and a future cybersecurity or data privacy incident could have a material adverse effect on our results of operations and financial condition. While we maintain a broad array of information security and privacy measures, policies and practices, our networks may be breached through a variety of means, resulting in someone obtaining unauthorized access to our information, or that of our customers, or to our intellectual property; disabling or degrading service; or sabotaging systems or information. In addition, hardware, software, or applications we develop or procure from third parties may contain defects in design or manufacture or other problems that could unexpectedly compromise information security. Unauthorized parties may also attempt to gain access to our systems or facilities, or those of third parties with whom we do business, through fraud or other forms of deceiving our

## Table of Contents

employees, contractors, and vendors. Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. We will continue to incur significant costs to continuously enhance our information security measures to defend against the threat of cybercrime. Any cybersecurity or data privacy incident or breach may result in:

- loss of revenue resulting from the operational disruption;
- loss of revenue or increased bad debt expense due to the inability to invoice properly;
- loss of revenue due to loss of customers;
- material remediation costs to restore systems;
- material investments in new or enhanced systems in order to enhance our information security posture;
- cost of incentives offered to customers to restore confidence and maintain business relationships;
- reputational damage resulting in the failure to retain or attract customers;
- costs associated with potential litigation or governmental investigations;
- costs associated with any required notices of a data breach;
- costs associated with the potential loss of critical business data; and
- other consequences of which we are not currently aware but will discover through the remediation process.

Our business is subject to a variety of domestic and international laws, rules, policies and other obligations regarding data protection.

We are subject to a complex array of federal, state and international laws relating to the collection, use, retention, disclosure, security and transfer of personally identifiable information and personal health information, with additional laws applicable in some jurisdictions where the information is collected from children. In many cases, these laws apply not only to transfers between unrelated third-parties but also to transfers between us and our subsidiaries. Many jurisdictions have passed laws in this area, and other jurisdictions are considering imposing additional restrictions. The European Commission adopted the European General Data Protection Regulation (the “GDPR”), which will be in effect as of May 2018. China adopted a new cybersecurity law as of June 2017, and there is an increase in regulation of biometric data globally, which may include voiceprints. Complying with the GDPR and other 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, and could affect our ability to retain and attract customers.

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

- cause our customers to lose confidence in our solutions;
- harm our reputation;
- expose us to litigation and liability; and
- require us to incur significant expenses for remediation.

Interruptions or delays in services could impair the delivery of our services and harm our business

Because our services are complex and incorporate a variety of hardware and proprietary and third-party software, our services may have errors or defects that could result in unanticipated downtime for our customers and harm to our reputation and our business. We have from time to time found defects in our services, and new errors in our services may be detected in the future. As we acquire companies, we may encounter difficulty in incorporating the acquired services or technologies into our services. Any damage to, or failure of, the systems that serve our customers in whole or in part could result in interruptions in our service. Interruptions in our service may reduce our revenue, cause us to issue credits or pay service level agreement penalties, cause customers to terminate their on-demand services, and



adversely affect our renewal rates and our ability to attract new customers.

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

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

Table of Contents

As part of our business strategy, we acquire other businesses and technologies, and our ability to realize the anticipated benefits of our acquisitions will depend on successfully integrating the acquired businesses.

As part of our business strategy, we have in the past acquired, and expect to continue to acquire, other businesses and technologies. 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. Successfully realizing the benefits of acquisitions involves 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;
- difficulty in incorporating acquired products and technologies into our products and technologies;
- potential difficulties in completing projects associated with in-process research and development;
- unanticipated expenses and delays in completing acquired development projects and technology integration and upgrades;
- challenges associated with managing additional, geographically remote businesses;
- impairment of relationships with partners and customers;
- assumption of unknown material liabilities of acquired companies;
- inaccurate projection of revenue and bookings plans of the acquired entity in the due diligence process;
- customers delaying purchases of our products pending resolution of product integration between our existing and our newly acquired products;
- entering markets or types of businesses in which we have limited experience; and
- potential loss of key employees of the acquired business.

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

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

Under accounting principles generally accepted in the United States of America, we record the market value of our common stock and other forms of consideration issued in connection with an acquisition as the cost of acquiring the company or business. We allocate 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 assets 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 three to ten years. Goodwill is not subject to amortization but is 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, 2017, we had identified intangible assets of approximately \$627.6 million, net of accumulated amortization, and goodwill of approximately \$3.6 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.

## Table of Contents

We have grown, and may continue to grow, through acquisitions, which could dilute our existing stockholders and/or increase our debt levels.

In connection with past acquisitions, we issued a substantial number of shares of our common stock as transaction consideration, including contingent 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 strategy to increase cloud services, term licensing and transaction-based recurring revenue may adversely affect our near-term revenue growth and results of operations.

Our ongoing shift from a perpetual software license model to cloud services, term licensing and transaction-based recurring revenue models will create a recurring revenue stream that is more predictable. The transition, however, creates risks related to the timing of revenue recognition. We also incur certain expenses associated with the infrastructures and selling efforts of our hosting offerings in advance of our ability to recognize the revenues associated with these offerings, which may adversely affect our near-term reported revenues, results of operations and cash flows. A decline in renewals of recurring revenue offerings in any period may not be immediately reflected in our results for that period but may result in a decline in our revenue and results of operations in future quarters.

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

We reported net losses of \$151.0 million, \$12.5 million and \$115.0 million in fiscal years 2017, 2016 and 2015, respectively, and have a total accumulated deficit of \$527.7 million as of December 31, 2017. If we are unable to return to 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.

If our efforts to execute our formal transformation program are not successful, our business could be harmed.

We have been executing a formal transformation program to focus our product investments on our growth opportunities, increase our operating efficiencies, reduce costs, and further enhance shareholder value through share buybacks. There can be no assurance that we will be successful in executing this transformation program or be able to fully realize the anticipated benefits of this program, within the expected timeframes, or at all. Additionally, if we are not successful in strategically aligning our product portfolio, we may not be able to achieve the anticipated benefits of this program. A failure to successfully reduce and re-align our costs could have an adverse effect on our revenue and on our expenses and profitability. As a result, our financial results may not meet our or the expectations of securities analysts or investors in the future and our business could be harmed.

Tax matters may cause significant variability in our financial results.

Our businesses are subject to income taxation in the United States, as well as in many tax jurisdictions throughout the world. Tax rates in these jurisdictions may be subject to significant change. If our effective tax rate increases, our operating results and cash flow could be adversely affected. Our effective income tax rate can vary significantly between periods due to a number of complex factors including:

- projected levels of taxable income;

- pre-tax income being lower than anticipated in countries with lower statutory rates or higher than anticipated in countries with higher statutory rates;

- increases or decreases to valuation allowances recorded against deferred tax assets;

- tax audits conducted and settled by various tax authorities;
- adjustments to income taxes upon finalization of income tax returns;
- the ability to claim foreign tax credits;
- the repatriation of non-U.S. earnings for which we have not previously provided for income taxes; and
- changes in tax laws and their interpretations in countries in which we are subject to taxation.

During 2014, Ireland enacted changes to the taxation of certain Irish incorporated companies effective as of January 2021. On October 5, 2015, the Organization for Economic Cooperation and Development released the Final Reports for its Action Plan on Base Erosion and Profit Shifting. The implementation of one or more of these reports in jurisdictions in which we operate, together

## Table of Contents

with the 2014 enactment by Ireland, could result in an increase to our effective tax rate. In addition, in December 2017, the U.S. Congress passed, and the President signed the Tax Cut and Jobs Act of 2017. We expect this new legislation to have a material impact on our GAAP tax results. We have determined that our GAAP tax provision for the first quarter of fiscal 2018 was benefited by approximately \$80 million driven by a revaluation of certain deferred tax assets and liabilities using the updated federal tax rates, offset in part by a one-time repatriation tax on non-US cash and earnings. Future changes in U.S. and non-U.S. tax laws and regulations could have a material effect on our results of operations in the periods in which such laws and regulations become effective as well as in future periods.

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.

Under the Sarbanes-Oxley Act of 2002, we were required to develop and are required to maintain an effective system of disclosure controls and internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements. In addition, our management is required to assess and certify the adequacy of our controls on a quarterly basis, and our independent auditors must attest and report on the effectiveness of our internal control over financial reporting on an annual basis. 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. Inaccurate and/or untimely financial statements 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 and ultimately could negatively impact our stock price due to a loss of investor confidence in the reliability of our financial statements.

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 customer relationships, patents and core technology, completed technology 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
- our market capitalization declining to 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 oversight, including 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.

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

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 and law actions alleging 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

## Table of Contents

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. 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 arrangements. Any of these could seriously harm our business.

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

Our success and competitive position depend in large part on our ability to obtain and maintain intellectual property rights protecting our products and services. We rely on a combination of patents, copyrights, trademarks, service marks, trade secrets, confidentiality provisions and licensing arrangements to establish and protect our intellectual property and proprietary rights. Unauthorized parties may attempt to copy or discover 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.

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

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

Our debt agreements contain, and any of our other future debt agreements or arrangements 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;
- repurchase 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.

## Table of Contents

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, 2017, we had \$2,587.0 million outstanding principal of debt, including \$450.0 million of senior note due in 2020, \$300.0 million of senior note due in 2024, and \$500.0 million of senior note due in 2026, \$46.6 million of 2.75% 2031 Debentures redeemable in November 2021, \$263.9 million of 1.5% 2035 Debentures redeemable in November 2021, \$676.5 million of 1.0% 2035 Debentures redeemable in December 2022, and \$350.0 million of 1.25% 2025 Debentures redeemable in April 2025. Investors may require us to redeem these debentures earlier than the dates indicated if the closing sale price of our common stock is more than 130% of the then current conversion price of the respective debentures 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 in cash or shares of our common stock, at our election. We also had a \$242.5 million Revolving Credit Facility under which \$4.5 million was committed to backing outstanding letters of credit issued and \$238.0 million was available for borrowing at December 31, 2017. Our debt level could have important consequences, for example it could:

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

The market price of our common stock has been and may continue to be subject to wide fluctuations, and this may make it difficult for you to resell the common stock when you want or at prices you find attractive. Our stock price historically has been, and may continue to be, volatile. Various factors contribute to the volatility of our stock price, including, for example, quarterly variations in our financial results, new product introductions by us or our competitors and general economic and market conditions. Sales of a substantial number of shares of our common stock by our largest stockholders, or the perception that such sales could occur, could also contribute to the volatility of our stock price. While we cannot predict the individual effect that any of 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. Moreover, companies that have experienced volatility in the market price of their stock often are subject to securities class action litigation. Any such litigation could result in substantial costs and divert management's attention and resources.

Current uncertainty in the global financial markets and the global economy may negatively affect the value of our investment portfolio.

Our investment portfolios, which include investments in money market funds, bank deposits and separately managed investment portfolios, are generally subject to credit, liquidity, counterparty, market and interest rate risks that may be

exacerbated by a global financial crisis or by uncertainty surrounding the United Kingdom's exit from the European Union. 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.

Table of Contents

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

Future issuances of substantial amounts of our common stock, whether in the public market or through private placements, including issuances in connection with acquisition activities, or the perception that such issuances 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 or contingent 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 by 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.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

## 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.

## EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
3.1	<u>Amended and Restated Certificate of Incorporation of the Registrant.</u>	10-Q	0-27038	3.2	5/11/2001	
3.2	<u>Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Registrant.</u>	10-Q	0-27038	3.1	8/9/2004	
3.3	<u>Certificate of Ownership and Merger.</u>	8-K	0-27038	3.1	10/19/2005	
3.4	<u>Amended and Restated Bylaws of the Registrant.</u>	8-K	0-27038	3.1	11/13/2017	
3.5	<u>Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Registrant, as amended.</u>	S-3	333-142182	3.3	4/18/2007	
31.1	<u>Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a).</u>					X
31.2	<u>Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a).</u>					X
32.1	<u>Certification Pursuant to 18 U.S.C. Section 1350.</u>					X
101.0	The following materials from Nuance Communications, Inc.'s Quarterly Report on Form 10-Q for the quarter ended 12/31/2017, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Operations, (ii) the Consolidated Statements of Comprehensive Income (Loss), (iii) the Consolidated Balance Sheets, (iv) the Consolidated Statements of Cash Flows, and (v) Notes to Unaudited Condensed Consolidated Financial Statements.					X

Table of Contents

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 9, 2018.

Nuance Communications, Inc.

By: /s/ Daniel D. Tempesta  
Daniel D. Tempesta  
Executive Vice President and Chief Financial Officer