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

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

Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2011

Or

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

Commission file number 0-27038

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

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

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

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

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

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of the Registrant s Common Stock, outstanding as of July 31, 2011, was 305,586,374.

NUANCE COMMUNICATIONS, INC.

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NUANCE COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

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

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

See accompanying notes.

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NUANCE COMMUNICATIONS, INC.

CONSOLIDATED BALANCE SHEETS

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

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

See accompanying notes.

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NUANCE COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

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

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

See accompanying notes.

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Presentation

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

Although we believe the disclosures in these financial statements are adequate to make the information presented not misleading, certain information normally included in the footnotes prepared in accordance with GAAP has been omitted. Accordingly, these financial statements should be read in conjunction with the audited financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2010. Interim results are not necessarily indicative of the results that may be expected for a full year.

2. Summary of Significant Accounting Policies

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

Accounting for collaboration agreements

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

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

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

Adoption of new accounting standards

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

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

Recently Issued Accounting Standards

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

In January 2010, the FASB issued ASU No. 2010-06, *Improving Disclosures about Fair Value Measurements (Topic 820) Fair Value Measurements and Disclosures* to add additional disclosures about the different classes of assets and liabilities measured at fair value, the valuation techniques and inputs used, the activity in Level 3 fair value measurements, and transfers between Levels 1, 2, and 3. Levels 1, 2 and 3 of fair value measurements are defined in Note 8 below. ASU 2010-06 was effective for us for the interim reporting period beginning January 1, 2010, except for the provisions related to activity in Level 3 fair value measurements. Those provisions are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. ASU 2010-06

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

3. Comprehensive Income (Loss)

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

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

4. Business Acquisitions

Fiscal 2011 Acquisitions

On June 15, 2011, we acquired all of the outstanding capital stock of Equitrac Corporation (Equitrac), a leading provider of print management solutions, for cash consideration of approximately $162 million. The acquisition was a taxable stock purchase and the goodwill resulting from this acquisition is not expected to be deductible for tax purposes. The results of operations of Equitrac have been included in our results of operations from June 15, 2011.

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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

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

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

Other Fiscal 2011 Acquisitions

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

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Proforma Results

In addition to the acquisitions of Equitrac and SVOX discussed above, on December 30, 2009, we acquired all of the outstanding capital stock of SpinVox Limited (Spinvox), a UK-based privately-held company engaged in the business of providing voicemail-to-text services. The following table shows unaudited pro forma results of operations as if we had acquired SpinVox, Equitrac and SVOX on October 1, 2009 (dollars in thousands, except per share amounts):

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

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

Acquisition-Related Costs, net

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

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

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

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

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Contingent Acquisition Payments

Earn-out Payments

For business combinations occurring subsequent to the adoption of ASC 805 in fiscal 2010, the fair value of any contingent consideration is established at the acquisition date and included in the total purchase price. The contingent consideration is then adjusted to fair value as an increase or decrease in current earnings in each reporting period. Contingent consideration related to acquisitions prior to our adoption of ASC 805 have been and will continue to be recorded as additional purchase price when the contingency is resolved and additional consideration is attributable.

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

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

Escrow and Holdback Arrangements

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

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

6. Goodwill and Intangible Assets

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

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

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

7. Financial Instruments and Hedging Activities

Cash Flow Hedges

Forward Currency Contracts

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

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

Other Derivatives not Designated as Hedges

Forward Currency Contracts

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

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

Security Price Guarantees

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

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

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

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

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

Derivatives Designated as Hedges for the Three Months Ended June 30,

	Amount of Gain (Loss) Recognized in OCI	Location and Amount of Gain (Loss) Reclassified from

			Accumulated OCI into Income (Effective Portion)		
	2011	2010		2011	2010
Foreign currency contracts	$ 16	$ (321)	Other income (expense), net	$ 481	$ (98)
Interest rate swaps	$	$ 1,109	N/A	$	$

Derivatives Designated as Hedges for the Nine Months Ended June 30,

	Amount of Gain (Loss) Recognized in OCI		Location and Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		
	2011	2010		2011	2010
Foreign currency contracts	$ 529	$ (99)	Other income (expense), net	$ 978	$ (190)
Interest rate swaps	$	$ 2,517	Interest expense	$	