Nuance Communications, Inc.
Form 10-Q
May 07, 2013
Table of Contents

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

Form 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2013
Or
¨ 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	01803
(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 ý No ¨

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

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

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

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

The number of shares of the Registrant's Common Stock, outstanding as of April 30, 2013 was 317,750,908.

NUANCE COMMUNICATIONS, INC.
TABLE OF CONTENTS

Part I. Financial Information

Item 1. Condensed Consolidated Financial Statements (unaudited)

NUANCE COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31,		Six Months Ended March 31,	
	2013	2012	2013	2012
	(Unaudited)			
	(In thousands, except per share amounts)			
Revenues:				
Product and licensing	$173,886	$176,466	$371,786	$341,200
Professional services and hosting	213,264	155,535	413,569	295,117
Maintenance and support	63,849	58,340	127,912	114,667
Total revenues	450,999	390,341	913,267	750,984
Cost of revenues:				
Product and licensing	22,943	17,691	49,252	36,455
Professional services and hosting	138,534	97,221	263,690	187,375
Maintenance and support	13,098	10,893	27,895	21,913
Amortization of intangible assets	16,610	14,867	32,920	29,801
Total cost of revenues	191,185	140,672	373,757	275,544
Gross profit	259,814	249,669	539,510	475,440
Operating expenses:				
Research and development	72,553	53,992	141,274	106,046
Sales and marketing	98,348	84,354	215,483	174,751
General and administrative	29,990	41,149	74,774	72,464
Amortization of intangible assets	26,001	21,905	51,427	45,108
Acquisition-related costs, net	15,448	14,986	31,181	29,597
Restructuring and other charges, net	5,062	2,536	6,729	5,400
Total operating expenses	247,402	218,922	520,868	433,366
Income from operations	12,412	30,747	18,642	42,074
Other (expense) income:				
Interest income	405	648	943	1,241
Interest expense	(33,878)	(19,951)	(67,995)	(37,671)
Other (expense) income, net	(4,113)	913	(7,421)	6,644
(Loss) income before income taxes	(25,174)	12,357	(55,831)	12,288
Provision (benefit) for income taxes	674	11,467	(7,887)	2,058
Net (loss) income	$(25,848)	$890	$(47,944)	$10,230
Net (loss) income per share:				
Basic	$(0.08)	$0.00	$(0.15)	$0.03
Diluted	$(0.08)	$0.00	$(0.15)	$0.03
Weighted average common shares outstanding:				
Basic	315,473	305,282	314,006	304,643
Diluted	315,473	322,642	314,006	321,792

See accompanying notes.

1

NUANCE COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

	Three Months Ended March 31,		Six Months Ended March 31,	
	2013	2012	2013	2012
	Unaudited (In thousands)			
Net (loss) income	$(25,848)	$890	$(47,944)	$10,230
Other comprehensive (loss) income:				
Foreign currency translation adjustment	(17,972)	16,479	(10,861)	1,674
Recognition of pension loss amortization	33	24	166	70
Unrealized losses on marketable securities	—	6	—	4
Unrealized gains on cash flow hedge derivatives	—	(20)	—	(20)
Total other comprehensive (loss) income, net	(17,939)	16,489	(10,695)	1,728
Comprehensive (loss) income	$(43,787)	$17,379	$(58,639)	$11,958

See accompanying notes.

Table of Contents

NUANCE COMMUNICATIONS, INC.
CONSOLIDATED BALANCE SHEETS

	March 31, 2013 (Unaudited)	September 30, 2012
	(In thousands, except per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$1,005,302	$1,129,761
Accounts receivable, less allowances for doubtful accounts of $6,334 and $6,933	372,571	381,417
Prepaid expenses and other current assets	108,333	102,564
Deferred tax asset	82,565	87,564
Total current assets	1,568,771	1,701,306
Land, building and equipment, net	132,648	116,134
Goodwill	3,224,086	2,955,477
Intangible assets, net	969,372	906,538
Other assets	195,863	119,585
Total assets	$6,090,740	$5,799,040
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Current portion of long-term debt	$4,847	$148,542
Redeemable convertible debentures	—	231,552
Contingent and deferred acquisition payments	25,007	49,685
Accounts payable	119,367	113,196
Accrued expenses and other current liabilities	169,324	215,178
Deferred revenue	249,934	206,610
Total current liabilities	568,479	964,763
Long-term debt	2,336,750	1,735,811
Deferred revenue, net of current portion	138,354	108,481
Deferred tax liability	189,282	160,614
Other liabilities	89,018	82,665
Total liabilities	3,321,883	3,052,334
Commitments and contingencies (Notes 4 and 15)		
Equity component of currently redeemable convertible debentures	—	18,430
Stockholders’ equity:		
Series B preferred stock, $0.001 par value; 15,000 shares authorized; 3,562 shares issued and outstanding (liquidation preference $4,631)	4,631	4,631
Common stock, $0.001 par value; 560,000 shares authorized; 321,193 and 315,821 shares issued and 317,442 and 312,070 shares outstanding	321	316
Additional paid-in capital	3,007,517	2,908,302
Treasury stock, at cost (3,751 shares)	(16,788)	(16,788)
Accumulated other comprehensive loss	(17,725)	(7,030)
Accumulated deficit	(209,099)	(161,155)
Total stockholders’ equity	2,768,857	2,728,276
Total liabilities and stockholders’ equity	$6,090,740	$5,799,040

See accompanying notes.

Table of Contents

NUANCE COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended March 31,	
	2013	2012
	(Unaudited) (In thousands)	
Cash flows from operating activities:		
Net (loss) income	$(47,944)	$10,230
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	102,576	90,290
Stock-based compensation	74,913	70,808
Non-cash interest expense	19,577	16,064
Deferred tax benefit	(24,228)	(11,230)
Other	(1,102)	1,412
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	30,281	(34,298)
Prepaid expenses and other assets	(11,517)	(4,149)
Accounts payable	2,147	15,841
Accrued expenses and other liabilities	9,501	(2,963)
Deferred revenue	61,830	38,048
Net cash provided by operating activities	216,034	190,053
Cash flows from investing activities:		
Capital expenditures	(29,588)	(37,775)
Payments for business and technology acquisitions, net of cash acquired	(474,259)	(126,833)
Proceeds from sales and maturities of marketable securities and other investments	181	20,759
Change in restricted cash balances	—	6,747
Net cash used in investing activities	(503,666)	(137,102)
Cash flows from financing activities:		
Payments of debt	(146,123)	(3,326)
Proceeds from long-term debt, net of issuance costs	352,392	676,037
Payments for repurchases of common stock	—	(199,997)
(Payments for) proceeds from settlement of share-based derivatives	(3,801)	9,020
Payments of other long-term liabilities	(1,320)	(5,391)
Excess tax benefits on employee equity awards	—	7,000
Proceeds from issuance of common stock from employee stock plans	13,085	17,431
Cash used to net share settle employee equity awards	(49,518)	(36,139)
Net cash provided by financing activities	164,715	464,635
Effects of exchange rate changes on cash and cash equivalents	(1,542)	1,930
Net (decrease) increase in cash and cash equivalents	(124,459)	519,516
Cash and cash equivalents at beginning of period	1,129,761	447,224
Cash and cash equivalents at end of period	$1,005,302	$966,740

See accompanying notes.

Table of Contents

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

1. Organization and Presentation

The consolidated financial statements include the accounts of Nuance Communications, Inc. (“Nuance”, “we”, 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, 2012. Interim results are not necessarily indicative of the results that may be expected for a full year.

2. Summary of Significant Accounting Policies

We have made no material changes to the significant accounting policies disclosed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

Recently Issued Accounting Standards

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update No. 2013-02, “Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income,” which amends Accounting Standards Codification 220, “Comprehensive Income.” The amended guidance requires entities to provide information about the amounts reclassified out of accumulated other comprehensive income by component. Additionally, entities are required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The amended guidance does not change the current requirements for reporting net income or other comprehensive income. The amendment is effective prospectively for annual periods, and interim periods within those annual periods, beginning after December 15, 2012. We believe adoption of this new guidance will not have a material impact on our financial statements as these updates have an impact on presentation only.

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

3. Business Acquisitions

Fiscal 2013 Acquisitions
During fiscal 2013, we acquired several businesses for total purchase consideration of $465.0 million. The most significant of these acquisitions was J.A. Thomas and Associates ("JA Thomas") in October 2012 for cash consideration totaling approximately $242.6 million together with a deferred payment of $25.0 million contingent on the continued employment of certain key executives. The deferred payment will be recorded as compensation expense over the requisite employment period, and included in acquisition-related costs, net in our consolidated statement of operations. JA Thomas provides Clinical Documentation Improvement solutions to hospitals, primarily in the U.S., and is included in our Healthcare segment. The remaining acquisitions are not material and were made in each of our segments. These acquisitions are treated as stock purchases for accounting purposes, and the goodwill resulting from these acquisitions is not expected to be deductible for tax purposes, except for JA Thomas where we may elect to treat this acquisition as a taxable merger under provisions contained in the Internal Revenue Service regulations. Should such an election be made in the future, the goodwill resulting from this acquisition would be deductible for tax purposes. The results of operations of these acquisitions have been included in our financial results from the applicable acquisition date. A summary of the preliminary allocation of the purchase consideration for our fiscal 2013 acquisitions is as follows (dollars in thousands):

	Fiscal 2013
Total purchase consideration:	
Cash	$465,043
Allocation of the purchase consideration:	
Cash	$21,299
Accounts receivable	23,717
Goodwill	281,510
Identifiable intangible assets (a)	157,052
Other assets	20,891
Total assets acquired	504,469
Current liabilities	(13,955)
Deferred tax liability	(23,933)
Other long term liabilities	(1,538)
Total liabilities assumed	(39,426)
Net assets acquired	$465,043

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

	Amount	Weighted Average Life (Years)
Core and completed technology	$19,831	5.7
Customer relationships	132,558	11.5
Trade name	4,283	4.6
Non-Compete agreements	380	3.0
Total	$157,052	

The preliminary fair value estimates for the assets acquired and liabilities assumed for certain acquisitions completed during fiscal 2013 and 2012 were based upon preliminary calculations and valuations and our estimates and assumptions for each of these acquisitions are subject to change as we obtain additional information for our estimates during the respective measurement periods (up to one year from the respective acquisition dates). The primary areas of preliminary estimates that were not yet finalized related to certain receivables and liabilities acquired and identifiable intangible assets.

Table of Contents

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

Fiscal 2012 Acquisitions

On June 1, 2012, we acquired all of the outstanding capital stock of Vlingo Corporation (“Vlingo”) for net cash consideration of $196.3 million, which excludes the amounts we received as a security holder of Vlingo, as described below. At the closing of the merger, $15.0 million of the merger consideration was deposited into an escrow account that will be held for twelve months after the closing date to satisfy any indemnification claims. Vlingo provides technology that turns spoken words into action by combining speech recognition and natural language processing technology to understand the user’s intent and take the appropriate action. The acquisition is treated as a stock purchase for accounting purposes, and the goodwill resulting from this acquisition is not expected to be deductible for tax purposes. The results of operations for Vlingo are included in our Mobile and Consumer Segment from the acquisition date.

On April 26, 2012, we acquired all of the outstanding capital stock of Transcend Services, Inc. (“Transcend”), a provider of medical transcription and editing services. The aggregate consideration payable to the former stockholders of Transcend was $332.3 million. The acquisition is treated as a stock purchase for accounting purposes, and the goodwill resulting from this acquisition is not expected to be deductible for tax purposes. The results of operations for Transcend are included in our Healthcare segment from the acquisition date.

Proforma Results

The following table shows unaudited pro forma results of operations as if we had acquired Vlingo and Transcend on October 1, 2011 (dollars in thousands, except per share amounts):

	Three Months Ended March 31,		Six Months Ended March 31,	
	2013	2012	2013	2012
Revenue	$450,999	$425,855	$913,267	$820,698
Net (loss) income	(25,848)	3,706	(47,944)	19,835
Net (loss) income per share (diluted)	$(0.08)	$0.01	$(0.15)	$0.06

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

Acquisition-Related Costs, net

Acquisition-related costs include costs related to business and other acquisitions, including potential acquisitions. These costs consist of (i) transition and integration costs, including retention payments, transitional employee costs and earn-out payments treated as compensation expense, as well as the costs of integration-related activities including services provided by third-parties; (ii) professional service fees, including third party costs related to the acquisition, and legal and other professional service fees associated with disputes and regulatory matters related to acquired entities; and (iii) adjustments to acquisition-related items that are required to be marked to fair value each reporting period, such as contingent consideration, and other items related to acquisitions for which the measurement period has ended.

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2013	2012	2013	2012
Transition and integration costs	$11,636	$2,844	$17,899	$6,213
Professional service fees	3,812	12,229	13,282	22,733
Acquisition-related adjustments	—	(87)	—	651

Total	$15,448	$14,986	$31,181	$29,597

7

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

4. Contingent Acquisition Payments

The fair value of any contingent consideration is established at the acquisition date and included in the total purchase price. The contingent consideration is then adjusted to fair value as an increase or decrease in current earnings included in acquisition-related costs, net in each reporting period.

In connection with our acquisition of JA Thomas in October 2012, we agreed to make deferred payments to the former shareholders of JA Thomas of up to $25.0 million in October 2014, contingent upon the continued employment of certain named executives and certain other conditions. The contingent payments will be reduced by amounts specified in the merger agreement in the event that any of the named executives terminates their employment prior to the payment date. The portion of the deferred payment that is payable to the named executives will be recognized as compensation expense over the two year employment period and included in acquisition-related costs, net in our consolidated statement of operations.

In connection with our acquisition of Swype, Inc. ("Swype") in October 2011, we agreed to make deferred payments to the former shareholders of Swype of up to $25.0 million in April 2013, contingent upon the continued employment of three named executives and certain other conditions. The contingent payments were subject to reduction by amounts specified in the merger agreement in the event that any of the three executives terminated their employment prior to the payment date or if any losses occurred to which we were entitled to indemnification under the merger agreement. The portion of the deferred payment that was payable to the three named executives was recognized as compensation expense over the 18 month employment period and included in acquisition-related costs, net in our consolidated statement of operations. The remaining liability is included in the total purchase consideration and has been recorded at its estimated fair value at the acquisition date of $16.4 million. In April 2013, upon completion of the required employment condition, we made a cash payment of $25.0 million to the former shareholders of Swype.

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. On October 4, 2012, the arbitration panel issued its decision that no additional payment to the former shareholders under the Vocada agreement was required. Certain of the Vocada shareholders have filed a motion to vacate this ruling. At March 31, 2013, we have not recorded any obligation related to this earn-out.

5. Goodwill and Intangible Assets

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

	Goodwill	Intangible Assets
Balance at September 30, 2012	$2,955,477	906,538
Acquisitions	281,510	162,410
Dispositions	(1,443)	(1,988)
Purchase accounting adjustments	(5,326)	(11,300)
Amortization	—	(84,347)
Effect of foreign currency translation	(6,132)	(1,941)
Balance at March 31, 2013	$3,224,086	$969,372

In April 2013, we determined that lower than expected results for our fiscal 2013 second quarter and the revised fiscal 2013 forecast for the full fiscal year earnings represent a triggering event requiring an interim goodwill impairment test. Our initial assessment does not indicate that we have an impairment in any of our reporting units, however we expect to complete an interim impairment test on all of our reporting units during the third quarter of fiscal 2013.

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

6. Financial Instruments and Hedging Activities
Derivatives Not Designated as Hedges
Forward Currency Contracts
We operate our business in countries throughout the world and transact business in various foreign currencies. Our foreign currency exposures typically arise from transactions denominated in currencies other than the local functional currency of our operations. We have a program that primarily utilizes foreign currency forward contracts to offset the risks associated with the effect of certain foreign currency exposures. Our program is designed so that increases or decreases in our foreign currency exposures are offset by gains or losses on the foreign currency forward contracts in order to mitigate the risks and volatility associated with our foreign currency transactions. Generally we enter into contracts for less than 90 days, and at March 31, 2013 and September 30, 2012, we had outstanding contracts with a total notional value of $90.4 million and $83.9 million, respectively.
We have not designated these forward contracts as hedging instruments pursuant to ASC 815, Derivatives and Hedging and accordingly, we record the fair value of these contracts at the end of each reporting period in our consolidated balance sheet, with changes in the fair value recorded in earnings as other (expense) income, net in our consolidated statements of operations.
Security Price Guarantees
From time to time we enter into agreements that allow us to issue shares of our common stock as part or all of the consideration related to partnering and technology acquisition activities. Generally these shares are issued subject to security price guarantees, which are accounted for as derivatives. We have determined that these instruments would not be considered equity instruments if they were freestanding. The security price guarantees require payment from either us to a third party, or from a third party to us, based upon the difference between the price of our common stock on the issue date and an average price of our common stock approximately six months following the issue date. Changes in the fair value of these security price guarantees are reported in earnings in each period as other (expense) income, net in our consolidated statements of operations.
The following is a summary of the outstanding shares subject to security price guarantees at March 31, 2013 (dollars in thousands):

Issue Date	Number of Shares Issued	Settlement Date	Total Value of Shares on Issue Date
March 1, 2013	17,124	September 1, 2013	$