

Nuance Communications, Inc.
Form 10-K
November 29, 2012

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

Form 10-K
(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934
For the fiscal year ended September 30, 2012

OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934
For the transition period from to

Commission file number 0-27038

NUANCE COMMUNICATIONS, INC.
(Exact name of Registrant as Specified in its Charter)
Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

94-3156479
(I.R.S. Employer
Identification No.)

1 Wayside Road
Burlington, Massachusetts
(Address of Principal Executive Offices)

01803
(Zip Code)

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

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

Title of Each Class	Name of Each Exchange on Which Registered
Common stock, \$0.001 par value	NASDAQ Stock Market LLC

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

None

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

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The aggregate market value of the outstanding common equity held by non-affiliates of the Registrant as of the last business day of the Registrant’s most recently completed second fiscal quarter was approximately \$5.3 billion based upon the last reported sales price on the Nasdaq National Market for such date. For purposes of this disclosure, shares of Common Stock held by officers and directors of the Registrant and by persons who hold more than 5% of the outstanding Common Stock have been excluded because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily conclusive.

The number of shares of the Registrant’s Common Stock, outstanding as of October 31, 2012, was 312,423,563.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant’s definitive Proxy Statement to be delivered to stockholders in connection with the Registrant’s 2013 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

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PART I

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks, uncertainties and assumptions that, if they never materialize or if they prove incorrect, could cause our consolidated results to differ materially from those expressed or implied by such forward-looking statements. All statements other than statements of historical fact are statements that could be deemed forward-looking, including statements pertaining to: our future revenue, cost of revenue, research and development expense, selling, general and administrative expenses, amortization of intangible assets and gross margin, earnings, cash flows and liquidity; our strategy relating to our segments; the potential of future product releases; our product development plans and investments in research and development; future acquisitions and anticipated benefits from acquisitions; international operations and localized versions of our products; our contractual commitments; our fiscal 2013 revenue and expense expectations and legal proceedings and litigation matters. You can identify these and other forward-looking statements by the use of words such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “intends,” “potential,” “continue” or the negative of such terms, or other comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth in Item 1A of this Annual Report under the heading “Risk Factors.” All forward-looking statements included in this document are based on information available to us on the date hereof. We will not undertake and specifically decline any obligation to update any forward-looking statements.

Item 1. Business

Overview

We are a leading provider of voice and language solutions for businesses and consumers around the world. Our solutions are used in healthcare, mobile, consumer, enterprise customer service, and imaging markets. We offer market-leading accuracy, natural language understanding capability, domain knowledge and implementation capabilities, built on our significant, long-term investments in research and development. Our solutions are based on our proprietary voice and language platform and are used every day by millions of people and thousands of businesses for tasks and services such as requesting information from a phone-based self-service solution, dictating medical records, searching the mobile Web by voice, entering a destination into a navigation system, or working with PDF documents. We offer our solutions to our customers in a variety of ways, including through products, hosting, professional services and maintenance and support. Our product revenues include embedded original equipment manufacturers (“OEM”) royalties, traditional enterprise licensing, term-based enterprise licensing and consumer-based sales. Our hosting revenues are primarily generated through on-demand service models, comprised of hosted transaction-based pricing arrangements that typically have multi-year terms. Hosting and maintenance and support revenues are recurring in nature as our customers need to use our products on a repeat basis to handle their needs in medical transcription, enterprise customer service and mobile connected services.

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

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

We are organized in four segments: Healthcare, Mobile and Consumer, Enterprise, and Imaging. We leverage our voice and language platform to deliver custom, domain-specific solutions across these four segments. In fiscal 2012, segment revenue as a percentage of total segment revenue for Healthcare, Mobile and Consumer, Enterprise and Imaging was 39%, 29%, 19% and 13%, respectively. In fiscal 2011, segment revenue as a percentage of total segment revenue for Healthcare, Mobile and Consumer, Enterprise and Imaging was 38%, 28%, 21% and 13%, respectively. See Note 22 to the consolidated financial statements for additional information about our reportable segments.

Healthcare

The healthcare industry is under significant pressure to streamline operations, reduce costs and improve patient care. In recent years, healthcare organizations such as hospitals, clinics, medical groups, physicians' offices and insurance providers have increasingly turned to improving their clinical documentation process from capturing the physician voice to creating documentation through the use of the information to improve the delivery of care, quality measures, coding accuracy and appropriate reimbursement.

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We provide comprehensive dictation and transcription solutions and services that capture the patient encounters with their physician. These hosted and on-premise solutions provide platforms to generate and distribute clinical documentation through the use of advanced dictation and transcription features, and allow us to deliver scalable, highly productive medical transcription solutions. Additionally, we offer solutions that leverage the captured information and, with state-of-the-art coding, compliance and record management, which streamlines Healthcare Information Management ("HIM") processes to drive compliance and reimbursement. Through Clinical Documentation Improvement ("CDI") programs, we assist in bridging the gap between physicians and coders.

We are uniquely positioned to accelerate future innovation to transform the entire process of clinical documentation, as we are deeply entrenched in the physician base with our voice capture solutions and have the ability to leverage our Clinical Language Understanding technology to power clinical, coder and CDI specialist solutions that intelligently bridge documentation, CDI, coding and compliance. As many physicians adopt mobile devices, we migrate to mobile and cloud based solutions, supporting our transcription solutions as well as solutions that could be easily integrated by independent software vendors in to their mobile electronic health record clients. These solutions will significantly streamline speed and completeness of documentation so that providers can shorten the time between the patient visit and the payment for that visit.

We utilize a focused, enterprise sales team and professional services organization to address the market and implementation requirements of the healthcare industry. Direct distribution is supplemented by distributors and partnerships with electronic medical records application and other healthcare IT providers including, but not limited to Allscripts, Cerner, Epic, GE, IBM, McKesson and the University of Pittsburgh Medical Center ("UPMC"). In some cases, our healthcare solutions are priced under a traditional software perpetual licensing model. However, certain of our healthcare solutions, in particular our transcription solution, are also offered on an on-demand model and priced by volume of usage (such as number of lines transcribed). We continue to experience an increased preference for on-demand pricing model. Representative customers include Advocate, Banner Health, Cleveland Clinic, Department of Veterans Affairs, HCA, Leahy Clinic, Kaiser Permanente, Mayo Clinic, NHS, Providence Health & Services, Sharp, Steward Sutter Health, Tenet, UPMC, U.S. Army and Wellspan.

Mobile and Consumer

We help consumers use the powerful capabilities of their phones, cars, tablets, desktop and portable computers, personal navigation devices and other consumer electronics by enabling the use of voice commands, text-to-speech and enhanced text input solutions to control and interact with these devices more easily and naturally, and to access the array of content and services available on the Internet. Our suite of Dragon general purpose desktop and portable computer dictation applications increases productivity by using speech to create documents, streamline repetitive and complex tasks, input data, complete forms and automate manual transcription processes. Today, an increasing number of people worldwide rely on mobile devices to stay connected, informed and productive. Our suite of mobile solutions and services provides a platform to build, implement and deploy custom solutions on a variety of mobile devices and other consumer electronics. We have focused in recent quarters on integrating our Dragon technology and brand initiatives across mobile and consumer markets.

Our portfolio of mobile and consumer solutions and services includes an integrated suite of voice control and text-to-speech solutions, dictation applications, predictive text technologies, mobile messaging services and emerging services such as dictation, Web search and voicemail-to-text. We utilize a focused, enterprise sales team and professional services organization to address market and implementation requirements. We utilize direct distribution, supplemented by partnerships with electronics suppliers and integrators such as Clarion, Harman Kardon and Rovi. Our solutions are used by mobile phone, automotive, personal navigation device, computer, television and other consumer electronic manufacturers and their suppliers, including Amazon, Apple, Audi, BMW, Ford, Garmin, GM,

HTC, Intel, LG Electronics, Mercedes Benz, Nintendo, Nokia, Panasonic, Samsung, Sharp, T-Mobile, TomTom and Toyota. Telecommunications carriers, web search companies and content providers are increasingly using our mobile search and communication solutions to offer value-added services to their subscribers and customers. Our embedded mobile solutions are sold to automobile and device manufacturers, generally on a royalty model priced per device sold, as well as on a volume of usage model and sometimes on a license model. Our connected mobile services are sold through telecommunications carriers, voicemail system providers, smartphone application developers or directly to consumers, and generally priced on a volume of usage model (such as per subscriber or per use). At the end of fiscal 2012, our mobile cloud services powered handsets, cars, televisions and other mobile devices in 34 languages. Representative connected services customers and partners include Cisco, Comcast, Esnatech, Mitel, Rogers, Siemens, Telefonica, Telstra, Time Warner Cable, TISA, T-Mobile and Vodafone. In addition, various smartphone application stores include hundreds of applications that utilize our technology, such as our Dragon Mobile Assistant, DragonDictation, DragonGo! and FlexT9, as well as third party applications including Amazon Price Check, Ask, Bon' App, Coupons.com, E*Trade, Grainger, Kraft, Merriam-Webster, On-Star, PlaySay, Recipe.com, Snapguide, Target, Vocre and Yellow Pages.

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During the fourth quarter of fiscal 2012, we shipped new versions of Dragon NaturallySpeaking for Windows and Dragon Dictate for Mac, which are currently available in eight languages. Our desktop and portable computer dictation solutions are generally sold under a traditional perpetual software license model. We utilize a combination of our global reseller network and direct sales to distribute our desktop and portable computer dictation products. Resellers include retailers such as Amazon, Best Buy and WalMart. Enterprise customers include organizations such as law firms, insurance agencies and government agencies. Representative customers include ATF, Exxon, FBI, IBM, Texas Department of Family Protective Services and Zurich.

Enterprise

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

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

Our solutions are used by a wide variety of enterprises in customer-service intensive sectors, including telecommunications, financial services, travel and entertainment, and government. Our speech solutions are designed to serve our global partners and customers and are available in approximately 80 languages and dialects worldwide. In addition to our own sales and professional services teams, we often work closely with industry partners, including Avaya, Cisco and Genesys, that integrate our solutions into their hardware and software platforms. Our enterprise solutions offerings include both a traditional software perpetual licensing model and an on-demand model and are priced by volume of usage (such as number of minutes callers use the system or number of calls completed in the system). Representative customers include Bank of America, Barclays, Cigna, Citibank, Comcast, Deutsche Bank, Disney, FedEx, OnStar, PG&E, U.K.HM Revenue & Customs, USAA, US Airways, Telecom Italia, Telefonica, T-Mobile, Wells Fargo and Verizon.

Imaging

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

and enterprise customers.

Our imaging solutions offer optical character recognition technology to deliver highly accurate document scanning and storage. We provide networked print management and comprehensive PDF applications designed specifically for business users. In addition, we offer applications that combine network scanning, network print management and PDF creation to quickly enable distribution of documents to users' desktops or to enterprise applications. Our host of services includes software development toolkits for independent software vendors. Our imaging solutions are generally sold under a traditional perpetual software license model, and some solutions are also offered as a hosted solution. We utilize a combination of our global reseller network and direct sales to distribute our imaging products. We license our software to multifunction printer manufacturers such as Brother, Canon, Dell, HP and Xerox, which bundle our solutions with multi-function devices, digital copiers, printers and scanners, on a royalty model, priced per unit sold. Representative customers include Aflac, Airbus, Amazon, Barclays, Blue Shield, Citibank, EMC, Ernst & Young, Eurostar, Franklin Templeton, Intuit, Johnson & Johnson, JP Morgan Chase, Nationwide, Norwegian Tax Authorities, Office Depot, Phillips, PricewaterhouseCoopers, UPS and US Department of Justice.

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Research and Development/Intellectual Property

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

We continue to invest in technologies to maintain our market-leading position and to develop new applications. Our technologies are covered by approximately 2,800 patents and 1,100 patent applications. Our intellectual property, whether purchased or developed internally, is critical to our success and competitive position and, ultimately, to our market value. We rely on a portfolio of patents, copyrights, trademarks, services marks, trade secrets, confidentiality provisions and licensing arrangements to establish and protect our intellectual property and proprietary rights. We incurred research and development expenses of \$225.4 million, \$179.4 million, and \$152.1 million in fiscal 2012, 2011 and 2010, respectively.

International Operations

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

Geographic revenue classification is based on the geographic areas in which our customers are located. For fiscal 2012, 2011 and 2010, 71%, 73% and 72% of revenue was generated in the United States and 29%, 27% and 28% of revenue was generated by our international operations, respectively.

Competition

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

Specialized Professional Services. Our superior technology, when coupled with the high quality and domain knowledge of our professional services organization, allows our customers and partners to place a high degree of confidence and trust in our ability to deliver results. We support our customers in designing and building powerful innovative applications that specifically address their needs and requirements.

International Appeal. The international reach of our products is due to the broad language coverage of our offerings, including our voice and language technology, which provides recognition for approximately 80 languages and dialects and natural-sounding synthesized speech in 65 languages, and supports a broad range of hardware platforms and operating systems. Our imaging technology supports more than 100 languages for Optical Character Recognition and document handling, with up to 20 screen language choices, including Asian languages.

Technological Superiority. Our voice, language and imaging technologies, applications and solutions are often recognized as the most innovative and proficient products in their respective categories. Our voice and language technology has industry-leading recognition accuracy and provides a natural, voice-enabled interaction with systems, devices and applications. Our imaging technology is viewed as the most accurate in the industry. Technology

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

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

In our segments, we compete with companies such as Adobe, M*Modal, Microsoft and Google. In addition, a number of smaller companies in both speech and imaging offer services, technologies or products that are competitive with our solutions in some markets. In certain markets, some of our partners such as Avaya, Cisco, Interville and Genesys develop and market products

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and services that might be considered substitutes for our solutions. Current and potential competitors have established, or may establish, cooperative relationships among themselves or with third parties to increase the ability of their technologies to address the needs of our prospective customers.

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

Employees

As of September 30, 2012, we had approximately 12,000 full-time employees in total, including approximately 1,000 in sales and marketing, approximately 2,000 in professional services, approximately 1,500 in research and development, approximately 800 in general and administrative and approximately 6,700 that provide transcription and editing services. Approximately 37 percent of our employees are based outside of the United States, the majority of whom provide transcription and editing services and are based in India. Our employees are not represented by any labor union and are not organized under a collective bargaining agreement, and we have never experienced a work stoppage. We believe that our relationships with our employees are generally good.

Company Information

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

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

Item 1A. Risk Factors

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

Risks Related to Our Business

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

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

- slowing sales by our distribution and fulfillment partners to their customers, which may place pressure on these partners to reduce purchases of our products;
- volume, timing and fulfillment of customer orders;
- our ability to generate additional revenue from our intellectual property portfolio;

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

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

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

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

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

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entering markets or types of businesses in which we have limited experience; and
potential loss of key employees of the acquired business.

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

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

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

- costs incurred to combine the operations of businesses we acquire, such as transitional employee expenses and employee retention, redeployment or relocation expenses;

- impairment of goodwill or intangible assets;

- amortization of intangible assets acquired;

- a reduction in the useful lives of intangible asset acquired;

- identification of or changes to assumed contingent liabilities, both income tax and non-income tax related after our final determination of the amounts for these contingencies or the conclusion of the measurement period (generally up to one year from the acquisition date), whichever comes first;

- charges to our operating results to eliminate certain duplicative pre-merger activities, to restructure our operations or to reduce our cost structure;

- charges to our operating results resulting from expenses incurred to effect the acquisition; and

- charges to our operating results due to the expensing of certain stock awards assumed in an acquisition.

Intangible assets are generally amortized over a five to fifteen year period. Goodwill and certain intangible assets with indefinite lives, are not subject to amortization but are subject to an impairment analysis, at least annually, which may result in an impairment charge if the carrying value exceeds its implied fair value. As of September 30, 2012, we had identified intangible assets of approximately \$906.5 million, net of accumulated amortization, and goodwill of approximately \$3.0 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.

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

We have a significant amount of debt. As of September 30, 2012, we had a total of \$2,270.7 million of gross debt outstanding, including \$143.5 million in term loans due in March 2013, \$487.1 million in term loans due in March 2016 under an amended and restated agreement signed in July 2011, \$700.0 million of senior notes due in 2020 and \$940.0 million in convertible debentures. In October, 2012, we issued \$350.0 million of senior notes due in 2020 and used \$143.5 million of the proceeds to prepay the term loans due in March 2013. Investors may require us to redeem the 2027 Debentures totaling \$250.0 million in aggregate principal amount in August 2014, or sooner if the closing sale price of our common stock is more than 120% of the then current conversion price for certain specified periods. If a holder elects to convert, we will be required to pay the principal amount in cash and any amounts payable in excess of the principal amount will be paid in cash or shares of our common stock, at our election. Investors may require us to redeem the 2031 Debentures, totaling \$690.0 million in aggregate principal amount in November 2017, or sooner if the closing sale price of our common stock is more than 130% of the then current conversion price for certain specified periods. If a holder elects to convert, we will be required to pay the principal amount in cash and any amounts payable in excess of the principal amount will be paid in cash or shares of our common stock, at our election. We also have a \$75.0 million revolving credit line available to us through March 2015. As of September 30, 2012, there were \$17.9 million of letters of credit issued, but there were no other outstanding borrowings under the revolving credit line. Our debt level could have important consequences, for example it could:

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

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

In addition, approximately \$630.6 million of our debt outstanding as of September 30, 2012 bears interest at variable rates. If market interest rates increase, our debt service requirements will increase, which would adversely affect our results of operations and cash flows.

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

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

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

Our ability to comply with these covenants is dependent on our future performance, which will be subject to many factors, some of which are beyond our control, including prevailing economic conditions. As a result of these covenants, our ability to respond to changes in business and economic conditions and to obtain additional financing, if needed, may be significantly

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restricted, and we may be prevented from engaging in transactions that might otherwise be beneficial to us. In addition, our failure to comply with these covenants could result in a default under our debt agreements, which could permit the holders to accelerate our obligation to repay the debt. If any of our debt is accelerated, we may not have sufficient funds available to repay the accelerated debt.

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

We reported net income of \$207.1 million and \$38.2 million in fiscal 2012 and 2011, respectively, net losses of \$19.1 million for the fiscal year 2010 and have a total accumulated deficit of \$161.2 million as of September 30, 2012. If we are unable to maintain profitability, the market price for our stock may decline, perhaps substantially. We cannot assure you that our revenue will grow or that we will maintain profitability in the future. If we do not achieve and maintain profitability, we may be required to raise additional capital to maintain or grow our operations. Additional capital, if available at all, may be highly dilutive to existing investors or contain other unfavorable terms, such as a high interest rate and restrictive covenants.

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

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

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

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

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

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

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

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

are unable to develop new products and enhance functionalities or technologies to adapt to these changes, or if we are unable to realize synergies among our acquired products and technologies, our business will suffer.

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

The SEC, as directed by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules requiring public companies to include a report of management on internal control over financial reporting in their annual reports on Form 10-K that contains an assessment by management of the effectiveness of our internal control over financial reporting. In addition, our independent registered public accounting firm must attest to and report on the effectiveness of our internal control over financial reporting. Any failure in the effectiveness of our system of internal control over financial reporting could have a material adverse impact on our ability to report our financial statements in an accurate and timely manner, could subject us to regulatory actions, civil or criminal penalties, shareholder litigation, or loss of customer confidence, which could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our financial statements, which ultimately could negatively impact our stock price. A significant portion of our revenue is derived, and a significant portion of our research and development activities are based, outside the United States. Our results could be harmed by economic, political, regulatory and other risks associated with these international regions.

Because we operate worldwide, our business is subject to risks associated with doing business internationally. We anticipate that revenue from international operations could increase in the future. Most of our international revenue is generated by sales in Europe and Asia. In addition, some of our products are developed and manufactured outside the United States and we have a large number of employees in India that provide transcription services. We also have a large number of employees in Canada, Germany and United Kingdom that provide professional services. A significant portion of the development of our voice and language products is conducted in Canada and Germany, and a significant portion of our imaging research and development is conducted in Hungary. We also have significant research and development resources in Austria, Belgium, Italy, and United Kingdom. Accordingly, our future results could be harmed by a variety of factors associated with international sales and operations, including:

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

We are exposed to fluctuations in foreign currency exchange rates.

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

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

We have significant intangible assets, including goodwill and intangibles with indefinite lives, which are susceptible to valuation adjustments as a result of changes in various factors or conditions. The most significant intangible assets are patents and core technology, completed technology, customer relationships and trademarks. Customer relationships are amortized on an accelerated basis based upon the pattern in which the economic benefits of customer

relationships are being utilized. Other identifiable intangible assets are amortized on a straight-line basis over their estimated useful lives. We assess the potential impairment of intangible assets on an annual basis, as well as whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors that could trigger an impairment of such assets include the following:

- significant underperformance relative to historical or projected future operating results;

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• significant changes in the manner of or use of the acquired assets or the strategy for our overall business;

• significant negative industry or economic trends;

• significant decline in our stock price for a sustained period;

changes in our organization or management reporting structure that could result in additional reporting units, which may require alternative methods of estimating fair values or greater disaggregation or aggregation in our analysis by reporting unit; and

• a decline in our market capitalization below net book value.

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

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

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

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

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

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

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

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

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

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

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

Current uncertainty in the global financial markets and the global economy may negatively affect our financial results. Our investment portfolio, which primarily includes investments in money market funds, is generally subject to credit, liquidity, counterparty, market and interest rate risks that may be exacerbated by the recent global financial crisis. If the banking system or the fixed income, credit or equity markets deteriorate or remain volatile, our investment portfolio may be impacted and the values and liquidity of our investments could be adversely affected.

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

- the demand for, and prices of, our products, licenses, or services are reduced as a result of actions by our competitors or otherwise; or

- our financial counterparties or other contractual counterparties are unable to, or do not, meet their contractual commitments to us.

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

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

- cause our clients to lose confidence in our solutions;

- harm our reputation;

- expose us to liability; and

- increase our expenses from potential remediation costs.

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

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

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

Risks Related to Our Intellectual Property and Technology

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

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

property and proprietary rights. Unauthorized parties may attempt to copy aspects of our products or to obtain, license, sell or otherwise use information that we

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regard as proprietary. Policing unauthorized use of our products is difficult and we may not be able to protect our technology from unauthorized use. Additionally, our competitors may independently develop technologies that are substantially the same or superior to our technologies and that do not infringe our rights. In these cases, we would be unable to prevent our competitors from selling or licensing these similar or superior technologies. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as the laws of the United States. Although the source code for our proprietary software is protected both as a trade secret and as a copyrighted work, litigation may be necessary to enforce our intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Litigation, regardless of the outcome, can be very expensive and can divert management efforts. Third parties have claimed and may claim in the future that we are infringing their intellectual property, and we could be exposed to significant litigation or licensing expenses or be prevented from selling our products if such claims are successful.

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

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

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

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

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

Risks Related to our Corporate Structure, Organization and Common Stock

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

As of September 30, 2012, Warburg Pincus, a global private equity firm, beneficially owned approximately 17.9% of our outstanding common stock, including 3,562,238 shares of our outstanding Series B Preferred Stock, each of which is convertible into one share of our common stock. Because of its large holdings of our capital stock relative to other

stockholders, this stockholder has a strong influence over matters requiring approval by our stockholders.

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

Our stock price historically has been, and may continue to be, volatile. Various factors contribute to the volatility of our stock price, including, for example, quarterly variations in our financial results, new product introductions by us or our competitors

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and general economic and market conditions. Sales of a substantial number of shares of our common stock by our largest stockholders, or the perception that such sales could occur, could also contribute to the volatility of our stock price. While we cannot predict the individual effect that these factors may have on the market price of our common stock, these factors, either individually or in the aggregate, could result in significant volatility in our stock price during any given period of time. Moreover, companies that have experienced volatility in the market price of their stock often are subject to securities class action litigation. If we were the subject of such litigation, it could result in substantial costs and divert management's attention and resources.

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

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

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

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

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

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

These provisions include:

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

Item 1B. Unresolved Staff Comments

None.

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Item 2. Properties

Our corporate headquarters and administrative, sales, marketing, research and development and customer support functions occupy approximately 234,000 square feet of space that we lease in Burlington, Massachusetts. We also lease additional properties in the United States and a number of foreign countries. The following table summarizes our significant properties as of September 30, 2012:

Location	Sq. Ft. (approx.)	Lease Term	Primary Use
Burlington, Massachusetts	234,000	March, 2018	Corporate headquarters and administrative, sales, marketing, research and development and customer support functions.
Melbourne, Florida	130,000	Owned	Administrative, customer support and professional services functions.
Montreal, Quebec	98,000	December, 2016	Research and development, professional services, customer support functions.
Sunnyvale, California	71,000	September, 2013	Administrative, research and development, professional services and customer support functions.
Bangalore, India	50,000	April, 2015	Transcription and editing services

In addition to the properties referenced above, we also lease a number of small sales and marketing offices in the United States and internationally. As of September 30, 2012, we were productively utilizing substantially all of the space in our facilities, except for space that has been subleased to third parties.

Item 3. Legal Proceedings

Like many companies in the software industry, we have from time to time been notified of claims that we may be infringing certain intellectual property rights of others. These claims have been referred to counsel, and they are in various stages of evaluation and negotiation. If it appears necessary or desirable, we may seek licenses for these intellectual property rights. There is no assurance that licenses will be offered by all claimants, that the terms of any offered licenses will be acceptable to us or that in all cases the dispute will be resolved without litigation, which may be time consuming and expensive, and may result in injunctive relief or the payment of damages by us. We do not consider the matters to be material either individually or in the aggregate at this time. Our view of the matters may change in the future as events related thereto unfold.

Item 4. Mine Safety Disclosures

Not applicable.

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PART II

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

Market Information

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

	Low	High
Fiscal 2011:		
First quarter	\$ 14.79	\$ 19.19
Second quarter	16.79	20.97
Third quarter	18.85	22.93
Fourth quarter	15.56	22.40
Fiscal 2012:		
First quarter	\$ 19.28	\$ 26.97
Second quarter	24.37	31.15
Third quarter	19.33	26.85
Fourth quarter	19.58	25.89

Holders

As of October 31, 2012, there were 765 stockholders of record of our common stock.

Dividend Policy

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

Issuer Purchases of Equity Securities

We have not announced any currently effective authorization to repurchase shares of our common stock.

Unregistered Sales of Equity Securities and Use of Proceeds

On August 14, 2012, we issued 795,848 shares of our common stock to International Business Machines Corporation as consideration for a collaboration agreement. The shares were issued in reliance upon an exemption from the registration requirements of the Securities Act of 1933, as amended, provided by Section 4(2) thereof because the issuance did not involve a public offering.

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Item 6. Selected Consolidated Financial Data

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

	Fiscal Year Ended September 30,					
	2012	2011	2010	2009	2008	
Operations:						
Total revenues	\$1,651.5	\$1,318.7	\$1,118.9	\$950.4	\$868.5	
Gross profit	1,046.6	818.9	709.6	590.8	552.8	
Income from operations	126.2	52.6	32.9	57.6	32.6	
(Benefit) provision for income taxes	(141.8)	(8.2)	18.0	40.4	14.6	
Net income (loss)	\$207.1	\$38.2	\$(19.1)	\$(19.4)	\$(37.0)	
Net Income(Loss) Per Share Data:						
Basic	\$0.67	\$0.13	\$(0.07)	\$(0.08)	\$(0.18)	
Diluted	\$0.65	\$0.12	\$(0.07)	\$(0.08)	\$(0.18)	
Weighted average common shares outstanding:						
Basic	306.4	302.3	287.4	253.6	209.8	
Diluted	320.8	316.0	287.4	253.6	209.8	
Financial Position:						
Cash and cash equivalents and marketable securities	\$1,129.8	\$478.5	\$550.0	\$527.0	\$261.6	
Total assets	5,799.0	4,095.3	3,769.7	3,499.5	2,846.0	
Long-term debt, net of current portion	1,735.8	853.0	851.0	848.9	847.3	
Total stockholders’ equity	2,728.3	2,493.4	2,297.2	2,043.0	1,471.7	
Selected Data and Ratios:						
Working capital	\$736.5	\$379.9	\$459.2	\$376.6	\$133.5	
Depreciation of property and equipment	31.7	27.6	21.6	18.7	16.4	
Amortization of intangible assets	155.5	143.3	135.6	115.4	82.6	
Gross margin percentage	63.4	% 62.1	% 63.4	% 62.2	% 63.7	%

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

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

Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks, uncertainties and assumptions that, if they never materialize or if they prove incorrect, could cause our consolidated results to differ materially from those expressed or implied by such forward-looking statements. These forward-looking statements include predictions regarding:

- our future revenue, cost of revenue, research and development expenses, selling, general and administrative expenses, amortization of intangible assets and gross margin;
- our strategy relating to our segments;

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

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

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

Overview

We are a leading provider of voice and language solutions for businesses and consumers around the world. Our solutions are used in healthcare, mobile, consumer, enterprise customer service, and imaging markets. We offer market-leading accuracy, natural language understanding capability, domain knowledge and implementation capabilities, built on our significant, long-term investments in research and development. Our solutions are based on our proprietary voice and language platform and are used every day by millions of people and thousands of businesses for tasks and services such as requesting information from a phone-based self-service solution, dictating medical records, searching the mobile Web by voice, entering a destination into a navigation system, or working with PDF documents. We offer our solutions to our customers in a variety of ways, including through products, hosting, professional services and maintenance and support. Our product revenues include embedded OEM royalties, traditional enterprise licensing, term-based enterprise licensing and consumer-based sales. Our hosting revenues are primarily generated through on-demand service models, comprised of hosted transaction-based pricing arrangements that typically have multi-year terms. Our hosting and maintenance and support revenues are recurring in nature as our customers need to use our products on a repeat basis to handle their needs in medical transcription, enterprise customer service and mobile connected services. Our professional services also offer a visible revenue stream, as we have a backlog of assignments that take time to complete.

We are organized in four segments; Healthcare, Mobile and Consumer, Enterprise, and Imaging. Our solutions and services address our four segments:

Healthcare. We provide a comprehensive set of solutions and services that support the clinical documentation process from capturing the patient encounter with their physician, to improved clinical documentation, coding, compliance and reimbursement. Our hosted and on-premise solutions provide platforms to generate and distribute clinical documentation through the use of advanced dictation and transcription features, and allow us to deliver scalable, highly productive medical transcription solutions. We offer solutions that leverage the captured information and with state-of-the-art coding, compliance and record management which streamlines health information management ("HIM") processes to drive compliance and reimbursement. Through Clinical Documentation Improvement programs, we bridge the gap between physicians and coders. These solutions will significantly streamline speed and completeness of documentation so that providers can shorten the time between the patient visit and the payment for that visit. Our solutions also enable us to accelerate future innovation to transform the way healthcare providers

document patient care, through improved interface with electronic medical records and extraction of clinical information to support the billing and insurance reimbursement processes. We also offer speech recognition solutions for radiology, cardiology, pathology and related specialties, that help healthcare providers dictate, edit and sign reports without manual transcription. Trends in our healthcare business include a growing customer preference for hosted solutions, increasing interest in the use of mobile devices to access healthcare systems and records, and increasing international interest. We continue to see strong demand for transactions which involve the sale and delivery of both software and non-software related services or products. Over the last several quarters, we have signed several new contracts for our hosted solutions, and the volume of lines processed in these services has steadily increased. We are investing to expand our product set to address these opportunities, expand our international capabilities, and reduce our time from contract signing to initiation of billable services.

Mobile and Consumer. Our portfolio of mobile and consumer solutions and services includes an integrated suite of

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voice control and text-to-speech solutions, dictation applications, predictive text technologies, mobile messaging services and emerging services such as dictation, Web search and voicemail-to-text. Our suite of Dragon general purpose desktop and portable computer dictation applications increases productivity by using speech to create documents, streamline repetitive and complex tasks, input data, complete forms and automate manual transcription processes. In particular, we have focused in recent quarters on integrating our Dragon technology and brand initiatives across mobile and consumer markets. Trends in our mobile-consumer segment include device manufacturers requiring custom applications to deliver unique and differentiated products, broadening keyboard technologies to take advantage of touch screens, increasing hands-free capabilities on cell phones and automobiles to address the growing concern of distracted driving, and the adoption of our technology on a broadening scope of devices, such as televisions, set-top boxes, e-book readers and tablet computers. We continue to see strong demand for transactions which involve the sale and delivery of both software and non-software related services or products. We are investing to increase our capabilities and capacity to help device manufacturers build custom applications, to increase the capacity of our data centers, to increase the number, kinds and capacity of network services, to enable developers to access our technology, and to expand both awareness and channels for our direct-to-consumer products.

Enterprise. We deliver a portfolio of customer service business intelligence and authentication solutions that are designed to help companies better support, understand and communicate with their customers. Our solutions include the use of technologies such as speech recognition, natural language understanding, text-to-speech, biometric voice recognition and analytics to automate caller identification and authorization, call steering, completion of tasks such as updates, purchases and information retrieval, and automated outbound notifications. Our solutions improve the customer experience, increase the use of self-service and enable new revenue opportunities. In addition, we offer solutions that can meet customer care needs through

- direct interaction with thin-client applications on cell phones, enabling customers to very quickly retrieve relevant information. Trends in our enterprise business include increasing interest in the use of mobile applications to access customer care systems and records, increasing interest in coordinating actions and data across customer care channels, and the ability of a broader set of hardware providers and systems integrators to serve the market. We are investing to expand our product set to address these opportunities, to increase efficiency of our hosted applications, expand our capabilities and capacity to help customers build custom applications, and broaden our relationships with new hardware and systems integrator partners serving the market.

Imaging. Our imaging solutions offer optical character recognition technology to deliver highly accurate document scanning and storage. We provide networked print management and comprehensive PDF applications designed specifically for business users. In addition, we offer applications that combine network scanning, network print management and PDF creation to quickly enable distribution of documents to users' desktops or to enterprise applications. Our host of services includes software development toolkits for independent software vendors. The imaging market is evolving to include more networked solutions, mobile access to networked solutions, and multi-function devices. We are investing to improve mobile access to our networked products, expand our distribution channels and embedding relationships, and expand our language coverage.

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

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

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

Strategy

In fiscal 2013, we will continue to focus on growth by providing market-leading, value-added solutions for our customers and partners through a broad set of technologies, service offerings and channel capabilities. We will also continue to focus on operating efficiencies, expense discipline and acquisition synergies to improve gross margins and operating margins. We intend to pursue growth through the following key elements of our strategy:

Extend Technology Leadership. Our solutions are recognized as among the best in their respective categories. We intend

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to leverage our global research and development organization and broad portfolio of technologies, applications and intellectual property to foster technological innovation and maintain customer preference for our solutions. We also intend to invest in our engineering resources and seek new technological advancements that further expand the addressable markets for our solutions.

Broaden Expertise in Vertical Markets. Businesses are increasingly turning to Nuance for comprehensive solutions rather than for a single technology product. We intend to broaden our expertise and capabilities to deliver targeted solutions for a range of industries including mobile device manufacturers, healthcare, telecommunications, financial services and government administration. We also intend to expand our global sales and professional services capabilities to help our customers and partners design, integrate and deploy innovative solutions.

Increase Subscription and Transaction Based Recurring Revenue. We intend to increase our subscription and transaction based offerings in our segments. The expansion of our subscription or transaction based solutions will enable us to deliver applications that our customers use on a repeat basis, and pay for on a per use basis, providing us with the opportunity to enjoy the benefits of recurring revenue streams.

Expand Global Presence. We intend to further expand our international resources to better serve our global customers and partners and to leverage opportunities in emerging markets such as Asia and Latin America. We continue to add regional executives and sales employees in different geographic regions to better address demand for voice and language based solutions and services.

Pursue Strategic Acquisitions and Partnerships. We have selectively pursued strategic acquisitions to expand our technology, solutions and resources to complement our organic growth. We have also formed key partnerships with other important companies in our markets of interest, and intend to continue to do so in the future where it will enhance the value of our business. We have proven experience in integrating businesses and technologies and in delivering enhanced value to our customers, partners, employees and shareholders. We intend to continue to pursue acquisitions that enhance our solutions, serve specific vertical markets and strengthen our technology portfolio.

Key Metrics

In evaluating the financial condition and operating performance of our business, management focuses on revenue, net income, gross margins, operating margins and cash flow from operations. A summary of these key financial metrics for the fiscal year ended September 30, 2012, as compared to the fiscal year ended September 30, 2011, is as follows:

- Total revenue increased by \$332.8 million to \$1,651.5 million;
- Net income improved by \$168.9 million to \$207.1 million;
- Gross margins increased by 1.3 percentage points to 63.4%;
- Operating margins increased by 3.6 percentage point to 7.6%; and
- Cash provided by operating activities for the fiscal year ended September 30, 2012 was \$473.0 million, an increase of \$115.6 million from the prior fiscal year.

In addition to the above key financial metrics, we also focus on certain non-financial performance indicators. A summary of these key non-financial performance indicators as of and for the period ended September 30, 2012, as compared to September 30, 2011, is as follows:

• Annualized line run-rate in our on-demand healthcare solutions increased 21% to approximately 4.8 billion lines per year. The annualized line run-rate is determined using billed equivalent line counts in a given quarter, multiplied by four; and

• Estimated 3-year value of on-demand contracts increased 43% to approximately \$1.9 billion. We determine this value by using our best estimate of all anticipated future revenue streams under signed on-demand contracts currently in place, whether or not they are guaranteed through a minimum commitment clause. Our best estimate is based on assumptions about launch dates, volumes and renewal rates within the three year period. Most of these contracts are priced by volume of usage and typically have no or low minimum commitments. Actual revenue could vary from our

estimates due to factors such as cancellations, non-renewals or volume fluctuations.

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RESULTS OF OPERATIONS

Total Revenues

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

	Fiscal 2012	Fiscal 2011	Fiscal 2010	% Change 2012 vs. 2011	% Change 2011 vs. 2010	
Product and licensing	\$740.7	\$607.4	\$473.5	21.9	% 28.3	%
Professional services and hosting	674.0	509.1	463.5	32.4	% 9.8	%
Maintenance and support	236.8	202.2	181.9	17.1	% 11.2	%
Total Revenues	\$1,651.5	\$1,318.7	\$1,118.9	25.2	% 17.9	%
United States	\$1,175.2	\$963.7	\$802.0	21.9	% 20.2	%
International	476.3	355.0	316.9	34.2	% 12.0	%
Total Revenues	\$1,651.5	\$1,318.7	\$1,118.9	25.2	% 17.9	%

Fiscal 2012 Compared to Fiscal 2011

The geographic split for fiscal 2012 was 71% of total revenue in the United States and 29% internationally, as compared to 73% of total revenue in the United States and 27% internationally for the same period last year. The increase in the proportion of revenue generated internationally was primarily due to contributions from our Mobile and Consumer and Imaging segments.

Fiscal 2011 Compared to Fiscal 2010

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

Product and Licensing Revenue

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

	Fiscal 2012	Fiscal 2011	Fiscal 2010	% Change 2012 vs. 2011	% Change 2011 vs. 2010	
Product and licensing revenue	\$740.7	\$607.4	\$473.5	21.9	% 28.3	%
As a percentage of total revenues	44.9	% 46.1	% 42.3	%		

Fiscal 2012 Compared to Fiscal 2011

Product and licensing revenue for fiscal 2012 increased \$133.3 million, as compared to fiscal 2011. The increase consisted of a \$74.6 million increase in Mobile and Consumer revenue primarily driven by growth in sales of our embedded solutions. Imaging product and licensing revenue increased \$36.1 million, primarily driven by sales of our multi-functional peripheral (“MFP”) products, which included revenue associated with our acquisition of Equitrac in the third quarter of fiscal 2011.

Fiscal 2011 Compared to Fiscal 2010

Product and licensing revenue for fiscal 2011 increased \$133.9 million, as compared to fiscal 2010. The increase consisted of a \$50.1 million increase in Mobile and Consumer revenue primarily driven by \$31.6 million of growth in sales of our embedded solutions, and additional sales of \$18.5 million of Dragon consumer products. Imaging revenue increased by \$43.9 million, due to increased revenue from our MFP products. Healthcare revenue increased by \$23.0 million resulting in part from continued strength in Dragon Medical solutions, which represented \$12.8 million of the increase during the year. Enterprise on-premise license sales increased by \$16.9 million resulting from the continued increase in global demand for our core speech solutions.

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Professional Services and Hosting Revenue

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

	Fiscal 2012	Fiscal 2011	Fiscal 2010	% Change 2012 vs. 2011	% Change 2011 vs. 2010	
Professional services and hosting revenue	\$674.0	\$509.1	\$463.5	32.4	% 9.8	%
As a percentage of total revenues	40.8	% 38.6	% 41.4	%		

Fiscal 2012 Compared to Fiscal 2011

Professional services and hosting revenue for fiscal 2012 increased \$164.9 million, as compared to fiscal 2011. The increase consisted of a \$130.6 million increase in Healthcare revenue primarily driven by transactional volume growth in our on-demand solutions, of which \$77.4 million was due to our acquisitions closed during fiscal 2011 and 2012. Mobile and Consumer revenue increased \$30.9 million, primarily attributable to a \$16.0 million increase in professional services to support the implementation of our embedded handset and automotive solutions and a \$13.4 million increase driven by transactional volume growth in our connected mobile services.

Fiscal 2011 Compared to Fiscal 2010

Professional services and hosting revenue for fiscal 2011 increased \$45.6 million, as compared to fiscal 2010. The increase consisted of a \$40.1 million increase in Healthcare revenue primarily driven by transactional volume growth in our on-demand solutions. Mobile and Consumer revenue increased \$29.3 million as a result of growth of \$19.2 million in our connected mobile services and growth of \$10.1 million in professional services for our embedded solutions. Enterprise revenue decreased by \$24.4 million, primarily due to the decline of one on-demand customer's volume.

Maintenance and Support Revenue

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

	Fiscal 2012	Fiscal 2011	Fiscal 2010	% Change 2012 vs. 2011	% Change 2011 vs. 2010	
Maintenance and support revenue	\$236.8	\$202.2	\$181.9	17.1	% 11.2	%
As a percentage of total revenues	14.3	% 15.3	% 16.3	%		

Fiscal 2012 Compared to Fiscal 2011

Maintenance and support revenue for fiscal 2012 increased \$34.6 million, as compared to fiscal 2011. The increase was driven by growth in our product and licensing sales which included a \$15.8 million increase in Imaging revenue primarily due to our acquisition of Equitrac, and a \$10.2 million increase in Healthcare revenue driven by growth in sales of our Dragon Medical solutions.

Fiscal 2011 Compared to Fiscal 2010

Maintenance and support revenue for fiscal 2011 increased \$20.3 million, as compared to fiscal 2010. The increase was driven by growth in our product and licensing sales which included a \$7.5 million increase in Healthcare driven by Dragon Medical solutions, a \$5.5 million increase in Enterprise, and a \$5.3 million increase in Imaging with contributions from our acquisition of Equitrac.

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COSTS AND EXPENSES

Cost of Product and Licensing Revenue

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

	Fiscal 2012	Fiscal 2011	Fiscal 2010	% Change 2012 vs. 2011	% Change 2011 vs. 2010	
Cost of product and licensing revenue	\$74.8	\$65.6	\$49.6	14.0	% 32.3	%
As a percentage of product and licensing revenue	10.1	% 10.8	% 10.5	%		

Fiscal 2012 Compared to Fiscal 2011

Cost of product and licensing revenue for fiscal 2012 increased \$9.2 million, as compared to fiscal 2011. The increase was primarily due to a \$5.0 million increase in Imaging costs driven by our acquisition of Equitrac. Gross margin increased 0.7 percentage points primarily due to a mix shift toward our Mobile embedded solutions which carry a higher gross margin.

Fiscal 2011 Compared to Fiscal 2010

Cost of product and licensing revenue for fiscal 2011 increased \$16.0 million, as compared to fiscal 2010. The increase was primarily due to an increase in hardware costs associated with increased revenues from our MFP products in the Imaging segment. Gross margin remained relatively flat during the period.

Cost of Professional Services and Hosting Revenue

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

	Fiscal 2012	Fiscal 2011	Fiscal 2010	% Change 2012 vs. 2011	% Change 2011 vs. 2010	
Cost of professional services and hosting revenue	\$424.7	\$341.1	\$280.7	24.5	% 21.5	%
As a percentage of professional services and hosting revenue	63.0	% 67.0	% 60.6	%		

Fiscal 2012 Compared to Fiscal 2011

Cost of professional services and hosting revenue for fiscal 2012 increased \$83.6 million, as compared to fiscal 2011. The increase was primarily driven by a \$73.5 million increase in Healthcare costs related to growth in our on-demand solutions, including the impact from our acquisitions closed during fiscal 2011 and 2012. Gross margin increased 4.0 percentage points primarily due to a mix shift toward our Healthcare on-demand offerings which carry a higher gross margin and expanded margins due to an increase in automation services relating to our connected mobile solutions in our Mobile and Consumer segment.

Fiscal 2011 Compared to Fiscal 2010

Cost of professional services and hosting revenue for fiscal 2011 increased \$60.4 million, as compared to fiscal 2010. The increase was due to a \$29.6 million increase in Healthcare costs primarily related to growth in our on-demand solutions, and a \$16.8 million increase in stock-based compensation related to our professional services personnel. Gross margin relative to our professional services and hosting revenue decreased 6.4 percentage points primarily due to increased stock-based compensation expense reducing gross margin by 3.3 percentage points and the remainder is primarily related to volume and revenue declines from one on-demand Enterprise customer.

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Cost of Maintenance and Support Revenue

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

	Fiscal 2012	Fiscal 2011	Fiscal 2010	% Change 2012 vs. 2011	% Change 2011 vs. 2010	
Cost of maintenance and support revenue	\$45.3	\$38.1	\$31.3	18.9	% 21.7	%
As a percentage of maintenance and support revenue	19.1	% 18.8	% 17.2	%		

Fiscal 2012 Compared to Fiscal 2011

Cost of maintenance and support revenue for fiscal 2012 increased \$7.2 million, as compared to fiscal 2011. The increase was primarily due to a \$6.9 million increase in Imaging costs related to the increase revenues from our Imaging MFP products, which included the impact from the Equitrac acquisition in fiscal 2011. Gross margin remained relatively flat during the period.

Fiscal 2011 Compared to Fiscal 2010

Cost of maintenance and support revenue for fiscal 2011 increased \$6.8 million, as compared to fiscal 2010. The increase included a \$2.5 million increase in costs due to higher volumes of Enterprise application maintenance and support, a \$2.1 million increase in costs related to increased revenue from our MFP products in our Imaging business, which included the impact from our acquisition of Equitrac, and a \$1.4 million increase in stock-based compensation expense. The increase in stock-based compensation expense reduced gross margin by 0.7% during the period. Excluding impact from stock-based compensation, gross margin remained relatively flat during the period.

Research and Development Expense

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

	Fiscal 2012	Fiscal 2011	Fiscal 2010	% Change 2012 vs. 2011	% Change 2011 vs. 2010	
Research and development expense	\$225.4	\$179.4	\$152.1	25.6	% 17.9	%
As a percentage of total revenues	13.6	% 13.6	% 13.6	%		

Fiscal 2012 Compared to Fiscal 2011

Research and development expense for fiscal 2012 increased \$46.0 million, as compared to fiscal 2011. The increase was attributable to a \$35.8 million increase in compensation expense, driven by headcount growth including additional headcount from our acquisitions during the period.

Fiscal 2011 Compared to Fiscal 2010

Research and development expense for fiscal 2011 increased \$27.3 million, as compared to fiscal 2010. The increase was attributable to a \$28.6 million increase in compensation expense, driven by a \$14.9 million increase in stock-based compensation expense and headcount growth as well as additional headcount from our acquisitions during the period. The increase was offset by reimbursement of \$5.9 million under a new collaboration agreement signed during the period as discussed in Note 2 of our Notes to Consolidated Financial Statements.

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

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table shows sales and marketing expense, in dollars and as a percentage of total revenue (dollars in millions):

	Fiscal 2012	Fiscal 2011	Fiscal 2010	% Change 2012 vs. 2011	% Change 2011 vs. 2010
Sales and marketing expense	\$369.2	\$306.4	\$266.2	20.5	% 15.1
As a percentage of total revenues	22.4	% 23.2	% 23.8	%	

Fiscal 2012 Compared to Fiscal 2011

Sales and marketing expense for fiscal 2012 increased \$62.8 million, as compared to fiscal 2011. The increase was primarily attributable to a \$35.9 million increase in compensation expense, driven primarily by additional headcount due to operational and acquisition growth and increased stock-based compensation expense. Additionally, marketing and channel program spending increased \$18.6 million to drive revenue growth as part of demand generation activities.

Fiscal 2011 Compared to Fiscal 2010

Sales and marketing expense for fiscal 2011 increased \$40.2 million, as compared to fiscal 2010. The increase was primarily attributable to a \$21.7 million increase in compensation expense, driven primarily by additional headcount to support growth and a \$5.1 million increase in stock-based compensation expense. Additionally, marketing and channel program spending increased \$14.0 million to drive overall revenue growth.

General and Administrative Expense

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

Fiscal 2012	Fiscal 2011
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