Nuance Communications, Inc.
Form 10-Q
May 10, 2018

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

Form 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018
Or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 000-27038

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

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

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

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

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

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

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

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

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

The number of shares of the Registrant's Common Stock, outstanding as of May 3, 2018 was 295,432,178.

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NUANCE COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31,		Six Months Ended March 31,	
	2018	2017	2018	2017
	(Unaudited)			
	(In thousands, except per share amounts)			
Revenues:				
Professional services and hosting	$274,574	$258,690	$533,601	$512,107
Product and licensing	161,284	159,258	323,094	311,010
Maintenance and support	78,366	81,625	159,174	164,114
Total revenues	514,224	499,573	1,015,869	987,231
Cost of revenues:				
Professional services and hosting	181,051	164,170	353,579	329,062
Product and licensing	18,966	18,790	38,035	37,168
Maintenance and support	14,191	13,240	28,432	26,838
Amortization of intangible assets	14,780	17,218	30,136	32,760
Total cost of revenues	228,988	213,418	450,182	425,828
Gross profit	285,236	286,155	565,687	561,403
Operating expenses:				
Research and development	74,185	66,232	147,551	132,554
Sales and marketing	94,187	93,674	196,147	195,190
General and administrative	74,288	41,518	127,180	81,308
Amortization of intangible assets	22,670	27,912	45,734	55,771
Acquisition-related costs, net	2,360	5,379	7,921	14,405
Restructuring and other charges, net	8,948	19,911	23,749	26,614
Impairment of goodwill	137,907	—	137,907	—
Total operating expenses	414,545	254,626	686,189	505,842
(Loss) income from operations	(129,309)	31,529	(120,502)	55,561
Other (expense) income:				
Interest income	2,236	1,280	4,428	2,303
Interest expense	(33,866)	(37,853)	(69,936)	(75,874)
Other expense, net	(570)	(19,623)	(792)	(20,232)
Loss before income taxes	(161,509)	(24,667)	(186,802)	(38,242)
Provision (benefit) for income taxes	2,544	9,141	(75,977)	19,494
Net loss	$(164,053)	$(33,808)	$(110,825)	$(57,736)
Net loss per share:				
Basic	$(0.56)	$(0.12)	$(0.38)	$(0.20)
Diluted	$(0.56)	$(0.12)	$(0.38)	$(0.20)
Weighted average common shares outstanding:				
Basic	294,103	291,021	292,720	289,976
Diluted	294,103	291,021	292,720	289,976

See accompanying notes.

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NUANCE COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

	Three Months Ended March 31,		Six Months Ended March 31,	
	2018	2017	2018	2017
	(Unaudited) (In thousands)			
Net loss	$(164,053)	$(33,808)	$(110,825)	$(57,736)
Other comprehensive income (loss):				
Foreign currency translation adjustment	4,096	17,947	5,611	(12,619)
Pension adjustments	—	118	116	236
Unrealized (loss) gain on marketable securities	(71)	27	(348)	(4)
Total other comprehensive income (loss), net	4,025	18,092	5,379	(12,387)
Comprehensive loss	$(160,028)	$(15,716)	$(105,446)	$(70,123)

See accompanying notes.

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NUANCE COMMUNICATIONS, INC.
CONSOLIDATED BALANCE SHEETS

	March 31, 2018	September 30, 2017
	(Unaudited)	
	(In thousands, except per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$468,642	$ 592,299
Marketable securities	153,008	251,981
Accounts receivable, less allowances for doubtful accounts of $12,458 and $14,333	411,648	395,392
Prepaid expenses and other current assets	107,929	88,269
Total current assets	1,141,227	1,327,941
Marketable securities	27,087	29,844
Land, building and equipment, net	172,521	176,548
Goodwill	3,472,849	3,590,608
Intangible assets, net	596,060	664,474
Other assets	147,016	142,508
Total assets	$5,556,760	$ 5,931,923
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$—	$ 376,121
Contingent and deferred acquisition payments (including $1.5 million due to a related party as of March 31, 2018, as more fully described in Note 16)	20,926	28,860
Accounts payable	92,767	94,604
Accrued expenses and other current liabilities	214,680	245,901
Deferred revenue	413,126	366,042
Total current liabilities	741,499	1,111,528
Long-term debt	2,311,484	2,241,283
Deferred revenue, net of current portion	469,575	423,929
Deferred tax liabilities	42,344	131,320
Other liabilities	98,176	92,481
Total liabilities	3,663,078	4,000,541
Commitments and contingencies (Note 15)		
Stockholders' equity:		
Common stock, $0.001 par value per share; 560,000 shares authorized; 298,330 and 293,938 shares issued and 294,580 and 290,187 shares outstanding, respectively	298	294
Additional paid-in capital	2,697,869	2,629,245
Treasury stock, at cost (3,751 shares)	(16,788)	(16,788)
Accumulated other comprehensive loss	(95,963)	(101,342)
Accumulated deficit	(691,734)	(580,027)
Total stockholders' equity	1,893,682	1,931,382
Total liabilities and stockholders' equity	$5,556,760	$ 5,931,923

See accompanying notes.

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NUANCE COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended March 31,	
	2018	2017
	(Unaudited) (In thousands)	
Cash flows from operating activities:		
Net loss	$(110,825)	$(57,736)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	107,055	116,644
Stock-based compensation	71,735	79,478
Non-cash interest expense	25,195	26,771
Deferred tax (benefit) provision	(90,331)	5,643
Loss on extinguishment of debt	—	18,565
Impairment of goodwill	137,907	—
Impairment of fixed asset	1,780	10,944
Other	579	2,342
Changes in operating assets and liabilities, excluding effects of acquisitions:		
Accounts receivable	(12,415)	(1,431)
Prepaid expenses and other assets	(22,059)	(12,295)
Accounts payable	(3,773)	(1,000)
Accrued expenses and other liabilities	5,230	(10,579)
Deferred revenue	85,287	72,988
Net cash provided by operating activities	195,365	250,334
Cash flows from investing activities:		
Capital expenditures	(25,326)	(18,787)
Payments for business and asset acquisitions, net of cash acquired (including cash payments of $3.5 million to a related party for fiscal 2018, see Note 16)	(12,768)	(72,990)
Purchases of marketable securities and other investments	(92,994)	(153,851)
Proceeds from sales and maturities of marketable securities and other investments	195,273	69,658
Net cash provided by (used in) investing activities	64,185	(175,970)
Cash flows from financing activities:		
Repayment and redemption of debt	(331,172)	(634,055)
Proceeds from issuance of long-term debt, net of issuance costs	—	838,959
Payments for repurchase of common stock	—	(99,077)
Acquisition payments with extended payment terms	(16,927)	—
Proceeds from issuance of common stock from employee stock plans	9,360	8,598
Payments for taxes related to net share settlement of equity awards	(44,006)	(43,353)
Other financing activities	(647)	(206)
Net cash (used in) provided by financing activities	(383,392)	70,866
Effects of exchange rate changes on cash and cash equivalents	185	(1,210)
Net (decrease) increase in cash and cash equivalents	(123,657)	144,020
Cash and cash equivalents at beginning of period	592,299	481,620
Cash and cash equivalents at end of period	$468,642	$625,640

See accompanying notes.

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

1. Organization and Presentation

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

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

2. Summary of Significant Accounting Policies

Recently Adopted Accounting Standards

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

Recently Issued Accounting Standards

In January 2018, the FASB issued ASU 2018-02, "Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income ("AOCI"), which is effective for fiscal years beginning after December 15, 2018 and interim periods therein, with early adoption permitted. The guidance gives entities the option to reclassify to retained earnings the tax effects resulting from the Tax Cuts and Jobs Act ("TCJA") related to items in AOCI. The new guidance may be applied retrospectively to each period in which the effect of the Act is recognized in the period of adoption. We do not expect the implementation to have a material impact on our consolidated financial statements.

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

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

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

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

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

3. Business Acquisitions

We continue to expand our solutions and integrate our technologies in new offerings through acquisitions. A summary of our acquisition activities is as follows:

Fiscal Year 2018

For the six months ended March 31, 2018, we completed an acquisition in our Healthcare segment for a total cash consideration of $8.7 million and contingent payments with a fair value of $0.5 million. As a result, we recognized goodwill of $6.8 million, and other intangible assets of $2.0 million, with a weighted average life of 2.0 years. The acquisition did not have a material impact on our condensed consolidated financial statements for the period.

In April 2018, we completed an acquisition in our Automotive segment for a total cash consideration of approximately $82 million, net of cash acquired. We are currently in the process of determining the total consideration transferred and the fair values of assets acquired and liabilities assumed, but do not expect this acquisition to have a material

impact on our condensed consolidated financial statements.
Fiscal Year 2017
For the six months ended March 31, 2017, we completed several acquisitions in our Enterprise, Healthcare and Mobile segments for a total cash consideration of $34.4 million, 0.8 million shares of common stock valued at $13.4 million and contingent payments with a fair value of $2.0 million. As a result, we recognized goodwill of $27.0 million, and other intangible assets of $22.5 million, with a weighted average life of 6.2 years. Such acquisitions were not significant individually or in the aggregate.

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

Acquisition-Related Costs, net

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

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2018	2017	2018	2017
Transition and integration costs	$3,367	$3,612	$7,429	$7,322
Professional service fees	940	2,974	1,451	7,991
Acquisition-related adjustments	(1,947)	(1,207)	(959)	(908)
Total	$2,360	$5,379	$7,921	$14,405

4. Goodwill and Intangible Assets

The changes in the carrying amount of goodwill by reportable segment for the six months ended March 31, 2018 are as follows (dollars in thousands):

Goodwill

	Healthcare	Enterprise	Imaging	Mobile	Automotive	Other	Total
Balance as of September 30, 2017	$1,418,334	$673,472	$257,792	$1,241,010	$—	$—	$3,590,608
Acquisitions	6,775	—	—	—	—	—	6,775
Purchase accounting adjustments	(336)	—	—	2,697	—	—	2,361
Effect of foreign currency translation	1,725	3,536	407	5,344	—	—	11,012
Reorganization (Note 17)	—	11,991	—	(1,249,051)	1,080,453	156,607	—
Impairment charge [a]	—	—	—	—	—	(137,907)	(137,907)
Balance as of March 31, 2018	$1,426,498	$688,999	$258,199	$—	$1,080,453	$18,700	$3,472,849

[a] Represents accumulated impairment charge as of March 31, 2018.

Other Intangible Assets

The changes in the carrying amount of intangible assets for the six months ended March 31, 2018 are as follows (dollars in thousands):

	Intangible Assets
Balance at September 30, 2017	$ 664,474
Acquisitions	2,620
Acquisition from a related party (Note 16)	5,000
Amortization	(75,870)
Effect of foreign currency translation	(164)
Balance at March 31, 2018	$ 596,060

Interim Impairment Analysis

As more fully described in Note 17, effective the second quarter of fiscal year 2018, our Automotive business, which was previously included within our Mobile segment, became a standalone operating segment. In addition, we moved our Dragon TV business from our Mobile operating segment into our Enterprise operating segment.

As a result of the reorganization, the original Mobile reporting unit was separated into three discrete lines of business comprised of Automotive, Dragon TV, and Devices. We assigned $1,080.5 million, $12.0 million, and $36.0 million of goodwill to Automotive, Dragon TV and Devices, respectively, based on their relative fair values as of March 31, 2018, and assessed the assigned goodwill

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

for impairment by comparing each component's fair value to its carrying amount. The fair values of Automotive and Dragon TV significantly exceeded their carrying amounts. However, the carrying value of Devices exceeded its fair value by $35.1 million. The standalone multi-year operating plan reflects the ongoing consolidation of our handset manufacturer customer base and continued erosion of our penetration of the remaining market. As a result, we recorded a $35.1 million goodwill impairment for the second quarter of fiscal 2018. After the impairment charge, the goodwill assigned to Devices as of March 31, 2018 was immaterial. The reorganization did not result in any impairment charge of other intangible assets for the second quarter of fiscal 2018.
Also during the second quarter of fiscal 2018, our Subscriber Revenue Services ("SRS") reporting unit, originally included within our Mobile operating segment, recorded significantly lower revenue and profitability due to recent market disruptions in certain markets that we serve. Our SRS business provides value-added services to mobile operators in emerging markets, primarily in India and Brazil. These markets have experienced recent and dramatic disruption as a result of accelerated change in competition and business models for our mobile operator customers. Specifically, the rapid shift away from a model where voice, data and text are offered separately toward unlimited bundled services at considerably lower costs has significantly reduced mobile operators' demand for our services. This reduced demand materially impacts our future expectations for SRS revenues. As a result, executive management performed an updated strategic assessment and reduced the long-term growth rates and profitability contemplated in SRS's multi-year operating plan. We concluded that these financial results coupled with the rapid market shifts being experienced in the industry were factors that represented impairment indicators, triggering a review of goodwill and indefinite-lived intangible assets for impairment during the second quarter of fiscal 2018. Based on the result of the impairment assessment, the carrying value of SRS exceeded its fair value by $94.3 million. In addition, we recorded an $8.5 million deferred tax benefit related to SRS's goodwill, which is amortized over time for tax purposes, and therefore increased the impairment charge by the same amount. As a result, we recorded a goodwill impairment charge of $102.8 million related to SRS for the second quarter of fiscal 2018. After the impairment charge, goodwill assigned to SRS was $17.8 million as of March 31, 2018. The assessment did not result in any impairment charge of other intangible assets for the second quarter of fiscal 2018.

For the purpose of the goodwill impairment analysis, the carrying value of each reporting unit is determined based on the allocation of assets and liabilities to the reporting unit based on the reporting unit's revenue and operating expenses as a percentage of our consolidated revenue and operating expenses. Certain corporate assets and liabilities that are not directly attributable to the reporting unit's operations and would not be transferred to a hypothetical purchaser of the reporting unit are excluded from the reporting unit's carrying amount.

The fair value of a reporting unit is generally determined using a combination of the income approach and the market approach, where the income approach is weighted 50% and the market approach 50%. The fair values of Devices and Dragon TV, however, were determined solely based upon the income approach due to the lack of comparable public companies or comparable acquisitions. For the income approach, fair value is determined based on the present value of estimated future after-tax cash flows, discounted at an appropriate risk-adjusted rate. We use our internal forecasts to estimate future after-tax cash flows and estimate the long-term growth rates based on our most recent views of the long-term outlook for each reporting unit. Actual results may differ from those assumed in our forecasts. We derive our discount rates using a capital asset pricing model and analyzing published rates for industries relevant to our reporting units to estimate the weighted average cost of capital. We use discount rates that are commensurate with the risks and uncertainty inherent in the respective businesses and in our internally developed forecasts. For the market approach, we use a valuation technique in which values are derived based on valuation multiples of comparable publicly traded companies. We assess each valuation methodology based upon the relevance and availability of the data at the time we perform the valuation and weight the methodologies appropriately.

Determining the fair value of a reporting unit involves the use of significant estimates and assumptions, all of which we believe are reasonable but nevertheless inherently uncertain. These estimates and assumptions include revenue growth rates and operating margins used to estimate future cash flows, risk-adjusted discount rates, future economic and market conditions, and the use of market comparables. Additionally, if we continue to experience lower-than-expected growth in a reporting unit or fail to sustain our profitability due to changing market dynamics, competition or technological obsolescence, it could adversely impact the long-term assumptions used in our goodwill impairment analysis. Such changes in assumptions and estimates may result in additional impairment of our goodwill and/or other long-lived assets, which could materially impact our future results of operations and financial conditions. Finally, as we continue to identify and assess other initiatives to better align our segment reporting structure with our long-term strategies, any additional changes in our organizational and segment reporting structure may result in additional impairment charges of goodwill and other intangible assets.

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

5. Financial Instruments and Hedging Activities
Derivatives Not Designated as Hedges
Forward Currency Contracts
We utilize foreign currency forward contracts to mitigate the risks associated with changes in foreign currency exchange rates. Generally, we enter into such contracts for less than 90 days and have no cash requirements until maturity. At March 31, 2018 and September 30, 2017, we had outstanding contracts with a total notional value of $78.0 million and $69.0 million, respectively.
We did not designate any forward contracts as hedging instruments for the six months ended March 31, 2018 or 2017. Therefore, changes in fair value of foreign currency forward contracts were recognized within other expense, net in our condensed consolidated statements of operations. The cash flows related to the settlement of forward contracts not designated as hedging instruments are included in cash flows from investing activities within our condensed consolidated statement of cash flows.
A summary of the derivative instruments as of March 31, 2018 and September 30, 2017 is as follows (dollars in thousands):

Derivatives Not Designated as Hedges	Balance Sheet Classification	Fair Value March 31, 2018