Nuance Communications, Inc.
Form 10-Q
May 10, 2011

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

Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2011

Or

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

Commission file number 0-27038

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

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

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

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

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

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

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

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

The number of shares of the Registrant s Common Stock, outstanding as of April 30, 2011, was 302,709,456.

NUANCE COMMUNICATIONS, INC.

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NUANCE COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31,		Six Months Ended March 31,	
	2011	2010	2011	2010
	(Unaudited) (In thousands, except per share amounts)			
Revenues:				
Product and licensing	$ 141,580	$ 113,161	$ 275,436	$ 226,388
Professional services and hosting	128,911	116,228	251,731	219,923
Maintenance and support	48,471	43,616	95,624	89,671
Total revenues	318,962	273,005	622,791	535,982
Cost of revenues:				
Product and licensing	14,984	10,702	32,130	23,293
Professional services and hosting	86,490	73,000	164,702	134,996
Maintenance and support	9,536	7,714	17,809	15,704
Amortization of intangible assets	14,163	12,184	27,454	23,202
Total cost of revenues	125,173	103,600	242,095	197,195
Gross profit	193,789	169,405	380,696	338,787
Operating expenses:				
Research and development	46,272	37,931	87,653	74,881
Sales and marketing	74,137	63,899	152,481	129,461
General and administrative	37,188	31,305	68,370	58,756
Amortization of intangible assets	21,572	22,201	44,249	44,327
Acquisition-related costs, net	2,314	7,962	5,315	20,767
Restructuring and other charges, net	2,428	12,372	4,479	12,987
Total operating expenses	183,911	175,670	362,547	341,179
Income (loss) from operations	9,878	(6,265)	18,149	(2,392)
Other income (expense):				
Interest income	659	173	1,486	609
Interest expense	(8,838)	(10,172)	(18,065)	(20,409)
Other income (expense), net	2,423	3,156	8,564	5,146
Income (loss) before income taxes	4,122	(13,108)	10,134	(17,046)
Provision for income taxes	2,387	2,288	8,408	2,628
Net income (loss)	$ 1,735	$ (15,396)	$ 1,726	$ (19,674)

Net income (loss) per share:				
Basic	$ 0.01	$ (0.05)	$ 0.01	$ (0.07)
Diluted	$ 0.01	$ (0.05)	$ 0.01	$ (0.07)
Weighted average common shares outstanding:				
Basic	300,937	284,994	299,772	281,998
Diluted	314,756	284,994	313,152	281,998

See accompanying notes.

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NUANCE COMMUNICATIONS, INC.

CONSOLIDATED BALANCE SHEETS

	March 31, 2011 (Unaudited)	September 30, 2010
	(In thousands, except per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 641,712	$ 516,630
Restricted cash (Note 9)	7,054	24,503
Marketable securities	26,305	5,044
Accounts receivable, less allowances for doubtful accounts of $5,881 and $6,301	228,622	217,587
Acquired unbilled accounts receivable	1,791	7,412
Prepaid expenses and other current assets	76,466	70,466
Total current assets	981,950	841,642
Land, building and equipment, net	69,135	62,083
Marketable securities	10,590	28,322
Goodwill	2,099,910	2,077,943
Intangible assets, net	627,368	685,865
Other assets	72,255	73,844
Total assets	$ 3,861,208	$ 3,769,699
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt and capital leases	$ 7,150	$ 7,764
Contingent and deferred acquisition payments	12,216	2,131
Accounts payable	84,588	78,616
Accrued expenses and other current liabilities	124,768	151,621
Deferred revenue	177,912	142,340
Total current liabilities	406,634	382,472
Long-term portion of debt and capital leases	851,963	851,014
Deferred revenue, net of current portion	78,049	76,598
Deferred tax liability	64,780	63,731
Other liabilities	84,229	98,688
Total liabilities	1,485,655	1,472,503
Commitments and contingencies (Notes 5 and 18)		
Stockholders equity:		
	4,631	4,631

Series B preferred stock, $0.001 par value; 15,000 shares authorized; 3,562 shares issued and outstanding (liquidation preference $4,631)		
Common stock, $0.001 par value; 560,000 shares authorized; 306,019 and 301,623 shares issued and 302,268 and 297,950 shares outstanding	306	302
Additional paid-in capital	2,641,136	2,581,901
Treasury stock, at cost (3,751 and 3,673 shares)	(16,788)	(16,788)
Accumulated other comprehensive income	25,897	8,505
Accumulated deficit	(279,629)	(281,355)
Total stockholders equity	2,375,553	2,297,196
Total liabilities and stockholders equity	$ 3,861,208	$ 3,769,699

See accompanying notes.

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NUANCE COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended March 31, 2011	2010
	(Unaudited) (In thousands)	
Cash flows from operating activities:		
Net income (loss)	$ 1,726	$ (19,674)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	84,723	77,977
Stock-based compensation	75,717	44,774
Non-cash interest expense	6,369	6,524
Non-cash restructuring and other expense		6,833
Deferred tax provision	564	(1,111)
Other	700	666
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	(2,519)	(8,541)
Prepaid expenses and other assets	(11,196)	(3,719)
Accounts payable	(1,446)	(2,249)
Accrued expenses and other liabilities	(31,035)	(10,357)
Deferred revenue	35,845	29,457
Net cash provided by operating activities	159,448	120,580
Cash flows from investing activities:		
Capital expenditures	(16,564)	(7,850)
Payments for acquisitions, net of cash acquired	(16,808)	(159,352)
Payments for acquired technology	(715)	(7,350)
Payments for equity investment		(14,970)
Purchases of marketable securities	(10,776)	
Proceeds from sales of marketable securities	6,650	
Change in restricted cash balances	17,184	
Net cash used in investing activities	(21,029)	(189,522)
Cash flows from financing activities:		
Payments of debt and capital leases	(4,091)	(4,064)
Payments of other long-term liabilities	(5,274)	(4,818)
(Payments) proceeds on settlement of share-based derivatives, net	(628)	3,784
Excess tax benefits on employee equity awards	4,020	
Proceeds from issuance of common stock from employee stock plans	14,611	18,823
Cash used to net share settle employee equity awards	(26,426)	(9,784)

Net cash (used in) provided by financing activities	(17,788)	3,941
Effects of exchange rate changes on cash and cash equivalents	4,451	(233)
Net increase (decrease) in cash and cash equivalents	125,082	(65,234)
Cash and cash equivalents at beginning of period	516,630	527,038
Cash and cash equivalents at end of period	$ 641,712	$ 461,804

See accompanying notes.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Presentation

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

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

2. Summary of Significant Accounting Policies

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

Adoption of new accounting standards

Effective October 1, 2010, we adopted the provisions in the Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements* (ASU 2009-13) and ASU 2009-14. *Software (Topic 985): Certain Revenue Arrangements that Include Software Elements* (ASU 2009-14). The provisions of ASU 2009-13 apply to arrangements that are outside the scope of software revenue recognition guidance and amend Accounting Standards Codification (ASC) Topic 605 to (1) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the consideration allocated; (2) require an entity to allocate revenue in an arrangement using the best estimated selling prices (BESP) of deliverables if a vendor does not have vendor-specific objective evidence (VSOE) or third-party evidence (TPE) of selling price; and (3) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method. ASU 2009-14 modifies the scope of ASC Topic 985 to remove industry specific revenue accounting guidance for software and software related transactions, tangible products containing software components and non-software components that function together to deliver the product s essential functionality. The adoption of these provisions did not have a material impact on our consolidated financial statements.

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

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

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Recently Issued Accounting Standards

In January 2010, the FASB issued ASU No. 2010-06, *Improving Disclosures about Fair Value Measurements (Topic 820) Fair Value Measurements and Disclosures* to add additional disclosures about the different classes of assets and liabilities measured at fair value, the valuation techniques and inputs used, the activity in Level 3 fair value measurements, and transfers between Levels 1, 2, and 3. Levels 1, 2 and 3 of fair value measurements are defined in Note 8 below. ASU 2010-06 was effective for us for the interim reporting period beginning January 1, 2010, except for the provisions related to activity in Level 3 fair value measurements. Those provisions are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. ASU 2010-06 impacts disclosure only and therefore, did not, and is not expected to, have a material impact on our financial statements.

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

3. Comprehensive Income (Loss)

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2011	2010	2011	2010
Net income (loss)	$ 1,735	$ (15,396)	$ 1,726	$ (19,674)
Other comprehensive income (loss):				
Foreign currency translation adjustment	18,416	(11,158)	16,745	(12,022)
Unrealized gain on cash flow hedge derivatives	12	727	519	1,538
Unrealized gain (loss) on marketable securities, net	77		(2)	
Recognition of pension loss amortization	89		130	
Other comprehensive income (loss)	18,594	(10,431)	17,392	(10,484)
Comprehensive income (loss)	$ 20,329	$ (25,827)	$ 19,118	$ (30,158)

4. Business Acquisitions

Proforma Results

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2011	**2010**	**2011**	**2010**
Revenue	$ 318,962	$ 273,005	$ 622,791	$ 547,958
Net income (loss)	1,735	(15,396)	1,726	(51,236)
Net income (loss) per share	$ 0.01	$ (0.05)	$ 0.01	$ (0.18)

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

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Acquisition-Related Costs, net

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

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010	Six Months Ended March 31, 2011	Six Months Ended March 31, 2010
Transition and integration costs	$ 96	$ 5,199	$ 1,053	$ 8,652
Professional service fees	1,994	2,556	3,332	11,854
Acquisition-related adjustments	224	207	930	261
Total	$ 2,314	$ 7,962	$ 5,315	$ 20,767

The decrease in acquisition-related costs, net for the three months ended March 31, 2011, as compared to the three months ended March 31, 2010, was primarily driven by a reduction in transition and integration costs. For the three months ended March 31, 2010, transition and integration costs consisted primarily of costs associated with transitional employees from our acquisitions of SpinVox and eCopy.

The decrease for the six months ended March 31, 2011, as compared to the six months ended March 31, 2010, was primarily driven by a reduction in transition and integration costs and professional services fees. For the six months ended March 31, 2010, transition and integration costs consisted primarily of the costs associated with transitional employees from our acquisitions of SpinVox and eCopy; professional services consisted of expenses related to our acquisition of SpinVox in December 2009 and approximately $2.2 million that had been capitalized as of September 30, 2009 related to transaction costs incurred in prior periods that was required to be expensed upon our adoption of ASC 805, *Business Combinations*, in fiscal 2010.

5. Contingent Acquisition Payments

Earn-out Payments

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

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

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

Escrow and Holdback Arrangements

In connection with certain of our acquisitions, we have placed either cash or shares of our common stock in escrow to satisfy any claims we may have. If no claims are made, the escrowed amounts will be released to the

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

former shareholders of the acquired companies. Historically, under the previous accounting guidance of SFAS No. 141, *Business Combinations* (SFAS 141), we could not make a determination, beyond a reasonable doubt, whether the escrow would become payable to the former shareholders of these companies until the escrow period had expired. Accordingly, these amounts were treated as contingent purchase price until it was determined that the escrow was payable, at which time the escrowed amounts would be recorded as additional purchase price and allocated to goodwill. Under the revised accounting guidance of ASC 805, escrow payments are generally considered part of the initial purchase consideration and accounted for as goodwill.

During the six months ended March 31, 2011, the last remaining escrowed amounts accounted for under previous accounting guidance expired. Payments totaling $5.2 million were released to former shareholders of X-Solutions Group B.V. and eCopy and were recorded as an increase to goodwill during the period.

6. Goodwill and Intangible Assets

The changes in the carrying amount of goodwill and intangible assets for the six months ended March 31, 2011, are as follows (dollars in thousands):

	Goodwill	Intangible Assets
Balance as of September 30, 2010	$ 2,077,943	$ 685,865
Acquisitions	7,586	8,811
Purchase accounting adjustments	4,645	648
Amortization		(71,703)
Effect of foreign currency translation	9,736	3,747
Balance as of March 31, 2011	$ 2,099,910	$ 627,368

During the six months ended March 31, 2011, in addition to several small purchases of intellectual property, we made an immaterial acquisition of a business that provides voice biometric products for total cash consideration of $12.6 million. Purchase accounting adjustments to goodwill recorded during the six months ended March 31, 2011, included $5.2 million of releases of escrow cash related to our fiscal 2009 acquisitions. This increase in goodwill was partially offset by a $1.4 million reduction resulting from the finalization of the Spinvox purchase accounting.

7. Financial Instruments and Hedging Activities

Cash Flow Hedges

Forward Currency Contracts

We enter into foreign currency contracts to hedge the variability of cash flows in Canadian Dollars (CAD) and Hungarian Forints (HUF) which are designated as cash flow hedges. These contracts settle monthly through October 2011. At March 31, 2011 and September 30, 2010, the notional value and the aggregate cumulative unrealized gains on the outstanding contracts were as follows:

	Notional Value		Aggregate Cumulative Unrealized Gains	
	March 31, 2011	September 30, 2010	March 31, 2011	September 30, 2010
Canadian Dollars	$ 4,917	$ 13,032	$ 412	$ 286
Hungarian Forints	1,591	4,564	333	443
Total contracts designated as cash flow hedges	$ 6,508	$ 17,596	$ 745	$ 729

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Other Derivatives not Designated as Hedges

Forward Currency Contracts

We operate our business in countries throughout the world and transact business in various foreign currencies. Our foreign currency exposures typically arise from transactions denominated in currencies other than the local functional currency of our operations. During fiscal 2011, we commenced a program that primarily utilizes foreign currency forward contracts to offset the risks associated with foreign currency denominated assets and liabilities. We established this program so that gains and losses from remeasurement or settlement of these assets and liabilities are offset by gains or losses on the foreign currency forward contracts thus mitigating the risks and volatility associated with our foreign currency transactions. Generally, we enter into contracts with terms of 30 days or less, and at March 31, 2011 we had outstanding contracts with a total notional value of $96.9 million.

We have not designated these forward contracts as hedging instruments pursuant to ASC 815, *Derivatives and Hedging* and accordingly, we recorded the fair value of these contracts at the end of each reporting period in our consolidated balance sheet, with changes in the fair value recorded in earnings as other income (expense), net in our consolidated statement of operations. During the three and six month periods ended March 31, 2011, we recorded gains of $2.2 million and losses of $0.5 million respectively, associated with these contracts.

Security Price Guarantees

From time to time we enter into agreements that allow us to issue shares of our common stock as part or all of the consideration related to partnering and technology acquisition activities. Generally these shares are issued subject to security price guarantees which are accounted for as derivatives. We have determined that these instruments would not be considered equity instruments if they were freestanding. The security price guarantees require payment from either us to a third party, or from a third party to us, based upon the difference between the price of our common stock on the issue date and an average price of our common stock approximately six months following the issue date. Changes in the fair value of these security price guarantees are reported in earnings in each period as other income (expense), net. During the three and six months ended March 31, 2011, we recorded gains of $3.2 million and $10.4 million, respectively, associated with these contracts. At March 31, 2011, the remaining contracts have matured and we have recorded a receivable of $10.0 million which was collected in April 2011.

The following table provides a summary of the fair value of our derivative instruments as of March 31, 2011 and September 30, 2010 (dollars in thousands):

		Fair Value	
Description	**Balance Sheet Classification**	**March 31, 2011**	**September 30, 2010**
Derivatives Not Designated as Hedges:			
Foreign currency contracts	Prepaid expenses and other current assets	$ 191	$ 767
Security price guarantees	Accrued expenses and other current liabilities		(982)

Net asset (liability) value of non-hedge derivative instruments		$	191	$	(215)
Derivatives Designated as Hedges:					
Foreign currency contracts	Prepaid expenses and other current assets	$	745	$	729
Interest rate swaps	Accrued expenses and other current liabilities				(503)
Net asset value of hedge derivative instruments		$	745	$	226

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables summarize the activity of derivative instruments for the three and six months ended March 31, 2011 and 2010, respectively (dollars in thousands):

Derivatives Designated as Hedges for the Three Months Ended March 31,

	Amount of Gain (Loss) Recognized in OCI		Location and Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		
	2011	2010		2011	2010
Foreign currency contracts	$ 351	$ 64	Other income (expense), net	$ 339	$ 92
Interest rate swaps	$	$ 751	N/A	$	$

Derivatives Designated as Hedges for the Six Months Ended March 31,

	Amount of Gain (Loss) Recognized in OCI		Location and Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		
	2011	2010		2011	2010
Foreign currency contracts	$ 513	$ 217	Other income (expense), net	$ 497	$ 92
Interest rate swaps	$	$ 1,408	Interest expense	$ (503)	$

Derivatives Not Designated as Hedges

	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income: Three Months Ended March 31,		Six Months Ended March 31,	
		2011	2010	2011	2010
Foreign currency contracts	Other income (expense), net	$ 2,223	$	$ (458)	$
Security price guarantees	Other income (expense), net	$ 3,234	$ 2,636	$ 10,449	$ 4,708

Other Financial Instruments

Financial instruments, including cash equivalents, restricted cash, marketable securities, accounts receivable, accounts payable and derivative instruments, are carried in the consolidated financial statements at amounts that approximate their fair value.

The fair value of our long-term debt was estimated to be $948.9 million and $902.2 million at March 31, 2011 and September 30, 2010, respectively. The increase in the fair value is primarily related to the convertible debt, reflecting the increase in the underlying stock price during the period. These fair value amounts represent the value at which our lenders could trade our debt within the financial markets, and do not represent the settlement value of these long-term debt liabilities to us at each reporting date. The fair value of the long-term debt issues will continue to vary each period based on fluctuations in market interest rates, changes to our credit ratings and, for the outstanding convertible debt, changes in our stock price. These fluctuations may have little to no correlation to our reported debt balances. The term loan portion of our Credit Facility is traded and the fair values are based upon traded prices as of the reporting dates. The fair values of the 2.75% Convertible Debentures at each respective reporting date were estimated using the averages of the March 31, 2011 and September 30, 2010 bid and ask trading quotes. We had no outstanding balance on the revolving credit line portion of our Credit Facility. Our capital lease obligations and other debt are not traded and the fair values of these instruments are assumed to approximate their carrying values as of March 31, 2011 and September 30, 2010.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Fair Value Measures

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

ASC 820, *Fair Value Measures and Disclosures,* establishes a value hierarchy based on three levels of inputs, of which the first two are considered observable and the third is considered unobservable:

Level 1. Quoted prices for identical assets or liabilities in active markets which we can access.

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

Level 3. Unobservable inputs.

Assets and liabilities measured at fair value on a recurring basis at March 31, 2011 and September 30, 2010 consisted of the following(dollars in thousands):

	March 31, 2011			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Money market funds(a)	$ 495,926	$	$	$ 495,926
Time Deposits(b)		26,765		26,765
US government agency securities(a)	1,000			1,000
Marketable securities, $36,867 at cost(b)		36,895		36,895
Foreign currency exchange contracts(b)		936		936
Total assets at fair value	$ 496,926	$ 64,596	$	$ 561,522
Liabilities:				
Contingent earn-out(d)			1,679	1,679
Total liabilities at fair value	$	$	$ 1,679	$ 1,679

	September 30, 2010			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				

Money market funds(a)	$ 470,845	$	$	$ 470,845
US government agency securities(a)	1,000			1,000
Marketable securities, $33,337 at cost(b)		33,366		33,366
Foreign currency exchange contracts(b)				