SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

SCHEDULE 13D/A

(Amendment No. 1)

INFORMATION TO BE INCLUDED IN STATEMENTS FILED PURSUANT TO § 240.13d-1(a)

AND AMENDMENTS THERETO FILED PURSUANT TO 240.13d-2(a)

Rice Midstream Partners LP

(Name of Issuer)

Common Units Representing Limited Partner Interests

(Title of Class of Securities)

762819100

(CUSIP Number)

Daniel J. Rice IV

400 Woodcliff Drive, Canonsburg, Pennsylvania 15317

Tel: (724) 746-6720

(Name, Address and Telephone Number of Person Authorized to Receive Notices and Communications)

February 18, 2016

(Date of Event which Requires Filing of this Statement)

If the filing person has previously filed a statement on Schedule 13G to report the acquisition that is the subject of this Schedule 13D, and is filing this schedule because of §§240.13d-1(e), 240.13d-1(f) or 240.13d-1(g), check the following box. ¨

Note. Schedules filed in paper format shall include a signed original and five copies of the schedule, including all exhibits. See §240.13d-7 for other parties to whom copies are to be sent.

* The remainder of this cover page shall be filled out for a reporting person s initial filing on this form with respect to the subject class of securities, and for any subsequent amendment containing information which would alter disclosures provided in a prior cover page.

The information required on the remainder of this cover page shall not be deemed to be filed for the purpose of Section 18 of the Securities Exchange Act of 1934 (Act) or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act (however, *see* the *Notes*).

1 NAME OF REPORTING PERSON

Rice Midstream GP Holdings LP

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP (see instructions)

(a): ¨ (b): ¨

3 SEC USE ONLY

4 SOURCE OF FUNDS (see instructions)

OO

5 CHECK IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED PURSUANT TO ITEMS 2(d) or 2(e) ¨

6 CITIZENSHIP OR PLACE OF ORGANIZATION

Delaware

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH	**7**	SOLE VOTING POWER -0-
	8	SHARED VOTING POWER 28,757,246 units*
	9	SOLE DISPOSITIVE POWER -0-
	10	SHARED DISPOSITIVE POWER 28,757,246 units*

11 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

28,757,246 units**

12 CHECK IF THE AGGREGATE AMOUNT IN ROW (11) EXCLUDES CERTAIN SHARES (see instructions) ¨

13 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)

40.55%**

14 TYPE OF REPORTING PERSON

OO (Limited Liability Company)

* Consists of 3,623 common units and 28,753,623 subordinated units representing limited partner interests in Rice Midstream Partners LP. Rice Midstream GP Holdings LP is the record holder of 3,623 common units and 28,753,623 subordinated units and the owner of all of the incentive distribution rights (which represent the right to receive increasing percentages of quarterly distributions in excess of specified amounts). The subordinated units may be converted into common units on a one-for-one basis upon the termination of the subordination period under certain circumstances as set forth in the Amended and Restated Agreement of Limited Partnership of Rice Midstream Partners LP, which is incorporated herein by reference to Exhibit 3.1 to Rice Midstream Partners LP s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 22, 2014.

** Based on a total of 42,163,749 common units and 28,753,623 subordinated units outstanding as of February 22, 2016.

1	NAME OF REPORTING PERSON Rice Midstream GP Management LLC		
2	CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP (see instructions) (a): ¨ (b): ¨		
3	SEC USE ONLY		
4	SOURCE OF FUNDS (see instructions) OO		
5	CHECK IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED PURSUANT TO ITEMS 2(d) or 2(e) ¨		
6	CITIZENSHIP OR PLACE OF ORGANIZATION Delaware		
NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH		**7**	SOLE VOTING POWER -0-
		8	SHARED VOTING POWER 28,757,246 units*
		9	SOLE DISPOSITIVE POWER -0-
		10	SHARED DISPOSITIVE POWER 28,757,246 units*

11	AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON 28,757,246 units**
12	CHECK IF THE AGGREGATE AMOUNT IN ROW (11) EXCLUDES CERTAIN SHARES (see instructions) ¨
13	PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11) 40.55%**
14	TYPE OF REPORTING PERSON OO (Limited Liability Company)

* Consists of 3,623 common units and 28,753,623 subordinated units representing limited partner interests in Rice Midstream Partners LP. Rice Midstream GP Holdings LP is the record holder of 3,623 common units and 28,753,623 subordinated units. Rice Midstream GP Management LLC may also be deemed to be the indirect beneficial owner of all of the incentive distribution rights (which represent the right to receive increasing percentages of quarterly distributions in excess of specified amounts). The subordinated units may be converted into common units on a one-for-one basis upon the termination of the subordination period under certain circumstances as set forth in the Amended and Restated Agreement of Limited Partnership of Rice Midstream Partners LP, which is incorporated herein by reference to Exhibit 3.1 to Rice Midstream Partners LP s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 22, 2014.

** Based on a total of 42,163,749 common units and 28,753,623 subordinated units outstanding as of February 22, 2016.

1	NAME OF REPORTING PERSON Rice Midstream Holdings LLC		
2	CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP (see instructions) (a): ¨ (b): ¨		
3	SEC USE ONLY		
4	SOURCE OF FUNDS (see instructions) OO		
5	CHECK IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED PURSUANT TO ITEMS 2(d) or 2(e) ¨		
6	CITIZENSHIP OR PLACE OF ORGANIZATION Delaware		
NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH		**7**	SOLE VOTING POWER -0-
		8	SHARED VOTING POWER 28,757,246 units*
		9	SOLE DISPOSITIVE POWER -0-
		10	SHARED DISPOSITIVE POWER 28,757,246 units*

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40.55%**

14 TYPE OF REPORTING PERSON

OO (Limited Liability Company)

* Consists of 3,623 common units and 28,753,623 subordinated units representing limited partner interests in Rice Midstream Partners LP. Rice Midstream GP Holdings LP is the record holder of 3,623 common units and 28,753,623 subordinated units. Rice Midstream Holdings LLC may also be deemed to be the indirect beneficial owner of all of the incentive distribution rights (which represent the right to receive increasing percentages of quarterly distributions in excess of specified amounts). The subordinated units may be converted into common units on a one-for-one basis upon the termination of the subordination period under certain circumstances as set forth in the Amended and Restated Agreement of Limited Partnership of Rice Midstream Partners LP, which is incorporated herein by reference to Exhibit 3.1 to Rice Midstream Partners LP s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 22, 2014.

** Based on a total of 42,163,749 common units and 28,753,623 subordinated units outstanding as of February 22, 2016.

1	NAME OF REPORTING PERSON Rice Energy Appalachia, LLC	
2	CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP (see instructions) (a): ¨ (b): ¨	
3	SEC USE ONLY	
4	SOURCE OF FUNDS (see instructions) OO	
5	CHECK IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED PURSUANT TO ITEMS 2(d) or 2(e) ¨	
6	CITIZENSHIP OR PLACE OF ORGANIZATION Delaware	

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH	**7**	SOLE VOTING POWER -0-
	8	SHARED VOTING POWER 28,757,246 units*
	9	SOLE DISPOSITIVE POWER -0-
	10	SHARED DISPOSITIVE POWER 28,757,246 units*

11 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

28,757,246 units**

12 CHECK IF THE AGGREGATE AMOUNT IN ROW (11) EXCLUDES CERTAIN SHARES (see instructions) ¨

13 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)

40.55%**

14 TYPE OF REPORTING PERSON

OO (Limited Liability Company)

* Consists of 3,623 common units and 28,753,623 subordinated units representing limited partner interests in Rice Midstream Partners LP. Rice Midstream GP Holdings LP is the record holder of 3,623 common units and 28,753,623 subordinated units. Rice Energy Appalachia, LLC may also be deemed to be the indirect beneficial owner of all of the incentive distribution rights (which represent the right to receive increasing percentages of quarterly distributions in excess of specified amounts). The subordinated units may be converted into common units on a one-for-one basis upon the termination of the subordination period under certain circumstances as set forth in the Amended and Restated Agreement of Limited Partnership of Rice Midstream Partners LP, which is incorporated herein by reference to Exhibit 3.1 to Rice Midstream Partners LP s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 22, 2014.

** Based on a total of 42,163,749 common units and 28,753,623 subordinated units outstanding as of February 22, 2016.

1	NAME OF REPORTING PERSON Rice Energy Inc.		
2	CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP (see instructions) (a): ¨ (b): ¨		
3	SEC USE ONLY		
4	SOURCE OF FUNDS (see instructions) OO		
5	CHECK IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED PURSUANT TO ITEMS 2(d) or 2(e) ¨		
6	CITIZENSHIP OR PLACE OF ORGANIZATION Delaware		
NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH		7	SOLE VOTING POWER -0-
		8	SHARED VOTING POWER 28,757,246 units*
		9	SOLE DISPOSITIVE POWER -0-
		10	SHARED DISPOSITIVE POWER 28,757,246 units*

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28,757,246 units**

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13 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)

40.55%**

14 TYPE OF REPORTING PERSON

OO (Limited Liability Company)

* Consists of 3,623 common units and 28,753,623 subordinated units representing limited partner interests in Rice Midstream Partners LP. Rice Midstream GP Holdings LP is the record holder of 3,623 common units and 28,753,623 subordinated units. Rice Energy Inc. may also be deemed to be the indirect beneficial owner of all of the incentive distribution rights (which represent the right to receive increasing percentages of quarterly distributions in excess of specified amounts). The subordinated units may be converted into common units on a one-for-one basis upon the termination of the subordination period under certain circumstances as set forth in the Amended and Restated Agreement of Limited Partnership of Rice Midstream Partners LP, which is incorporated herein by reference to Exhibit 3.1 to Rice Midstream Partners LP s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 22, 2014.

** Based on a total of 42,163,749 common units and 28,753,623 subordinated units outstanding as of February 22, 2016.

Schedule 13D

This Amendment No. 1 to Schedule 13D (the Amendment) amends and supplements the Schedule 13D originally filed by the Reporting Persons (as defined below) on December 23, 2014. Capitalized terms used herein but not defined herein shall have the meaning ascribed to them in the Schedule 13D. This Amendment amends the Schedule 13D as specifically set forth herein.

Item 1. Security and Issuer

This Schedule 13D relates to the common units representing limited partner interests (the common units) and subordinated units representing limited partner interests (the subordinated units , and together with the common units, the units), of Rice Midstream Partners LP, a Delaware limited partnership (the Issuer). The principal executive offices of the Issuer are located at 400 Woodcliff Drive, Canonsburg, Pennsylvania 15317.

Item 2. Identity and Background

Item 2 of the Schedule 13D is hereby amended and restated in its entirety to read as follows:

(a) This Schedule 13D is being filed jointly by each of the following persons:

(i) Rice Midstream GP Holdings LP, a Delaware limited partnership (GP Holdings);

(ii) Rice Midstream GP Management LLC, a Delaware limited liability company (GP Management);

(iii) Rice Midstream Holdings LLC, a Delaware limited liability company (Rice Midstream Holdings);

(iv) Rice Energy Appalachia, LLC, a Delaware limited liability company (REA); and

(v) Rice Energy Inc., a Delaware corporation (Rice Energy and together with GP Holdings, GP Management, Rice Midstream Holdings and REA, the Reporting Persons).

Rice Energy is a public company and owns 100% of the equity interests of REA. REA directly owns 100% of the outstanding Series A units in Rice Midstream Holdings. EIG Energy Fund XVI, L.P., a Delaware limited partnership, EIG Energy Fund XVI-E, L.P., a Delaware limited partnership, and EIG Holdings (RICE) Partners, LP, a Delaware limited partnership (collectively, the Purchasers) own the outstanding Series B units in Rice Midstream Holdings. Rice Midstream Holdings owns 100% of the equity interests of Rice Midstream Management LLC, a Delaware limited liability company and the general partner of the Issuer (the General Partner) and owns 100% of the outstanding membership interests in GP Management, the general partner of GP Holdings. Rice Midstream Holdings directly owns 91.75% of the outstanding limited partner interests in GP Holdings and the Purchasers own the remaining limited partner interests in Rice Midstream GP Holdings.

GP Holdings owns all of the incentive distribution rights in the Issuer (the incentive distribution rights). GP Holdings is a limited partner of the Issuer and the record holder of 3,623 common units and 28,753,623 subordinated units, representing a 40.55% limited partner interest in the Issuer.

(b) The address of the principal office of each of the Reporting Persons is 400 Woodcliff Drive, Canonsburg, Pennsylvania 15317.

(c) The name, residence or business address and present principal occupation or employment of each director and executive officer of each of the Reporting Persons are listed on Schedule I hereto.

(i) GP Holdings principal business is to hold common units and subordinated units;

(ii) GP Management s principal business is to act as the general partner of GP Holdings;

(iii) Rice Midstream Holdings principal business is to hold equity interests in certain subsidiaries that own certain gas gathering and water distribution assets as a wholly owned subsidiary of REA, to hold equity interests in GP Holdings and to act as the sole member of GP Management;

(iv) REA s principal business is to engage in certain natural gas exploration and production activities as a wholly-owned subsidiary of Rice Energy and to hold equity interests in Rice Midstream Holdings; and

(v) Rice Energy s principal business is natural gas exploration and production and to hold equity interests in its subsidiaries, including REA.

(d) During the last five years, none of the Reporting Persons nor any directors and executive officers of the Reporting Persons has been convicted in a criminal proceeding (excluding traffic violations and similar misdemeanors).

(e) During the last five years, none of the Reporting Persons was a party to a civil proceeding of a judicial or administrative body of competent jurisdiction and as a result of such proceeding has been or is subject to a judgment, decree or final order enjoining future violations of, or prohibiting or mandating activities subject to, U.S. federal or state securities laws or finding any violations with respect to such laws.

(f) Not applicable.

In accordance with the provisions of General Instruction C to Schedule 13D, information concerning the general partners, executive officers, board of directors and each person controlling the Reporting Persons, as applicable (collectively, the Covered Persons), required by Item 2 of Schedule 13D is provided on Schedule I and is incorporated by reference herein. To the Reporting Persons knowledge, none of the Covered Persons listed on Schedule I as a director or executive officer of GP Holdings, GP Management, Rice Midstream Holdings, REA or Rice Energy has been, during the last five years, (i) convicted in a criminal proceeding (excluding traffic violations or similar misdemeanors), or (ii) a party to a civil proceeding of a judicial or administrative body of competent jurisdiction and as a result of such proceeding was or is subject to a judgment, decree or final order enjoining future violations of, or prohibiting or mandating activities subject to, federal or state securities laws or finding any violation with respect to such laws.

Item 3. Source and Amount of Funds or Other Consideration

The information set forth in or incorporated by reference in Items 2, 4, 5 and 6 of this Schedule 13D is incorporated by reference in its entirety into this Item 3.

Item 4. Purpose of Transaction

Item 4 of the Schedule 13D is hereby amended and supplemented by the following:

The information set forth in or incorporated by reference in Items 2, 5 and 6 of this Schedule 13D is incorporated by reference in its entirety into this Item 4.

On February 17, 2016, Rice Midstream Holdings and GP Holdings entered into a securities purchase agreement (the Securities Purchase Agreement) with the Purchasers, pursuant to which (i) Rice Midstream Holdings agreed to sell 375,000 Series B Units (Series B Units) in Rice Midstream Holdings with an aggregate liquidation preference of $375.0 million and (ii) GP Holdings agreed to sell common units (GP Holdings Common Units) representing an 8.25% limited partner interest in GP Holdings for aggregate consideration of $375.0 million in a private placement (the Private Placement) exempt from the registration requirements under the Securities Act of 1933, as amended. The Private Placement closed on February 22, 2016 (the Closing Date).

In connection with the Private Placement, Rice Midstream Holdings transferred 3,623 common units representing limited partner interests in the Issuer and 28,753,623 subordinated units representing limited partner interests in the Issuer to GP Holdings pursuant to the Securities Purchase Agreement.

Except as described in this Item 4, the Reporting Persons do not have, as of the date of this Schedule 13D, any other plans or proposals that relate to or would result in any of the actions or events specified in this Item 4 of Schedule 13D. The Reporting Persons may change their plans or proposals in the future. In determining from time to time whether to sell the common units reported as beneficially owned in this Schedule 13D (and in what amounts) or to retain such securities, the Reporting Persons will take into consideration such factors as they deem relevant, including the business and prospects of the Issuer, anticipated future developments concerning the Issuer, existing and anticipated market conditions from time to time, general economic conditions, regulatory matters and other opportunities available to the Reporting Persons. The Reporting Persons reserve the right to acquire additional securities of the Issuer in the open market, in privately negotiated transactions (which may be with the Issuer or with third parties) or otherwise, to dispose of all or a portion of their holdings of securities of the Issuer or to change their intention with respect to any or all of the matters referred to in this Item 4.

Item 5. Interest in Securities of the Issuer

Item 5 of the Schedule 13D is hereby amended and supplemented by the following:

The information contained in rows 7, 8, 9, 10, 11 and 13 on the cover page of this Schedule 13D and the information set forth or incorporated by reference in Items 2, 3, 4 and 6 are hereby incorporated herein by reference.

(a)-(b) The following disclosure assumes that there are a total of 42,163,749 common units and 28,753,623 subordinated units of the Issuer, which are the number of common units and subordinated units of the Issuer outstanding following the Private Placement, based on the Issuer s annual report on Form 10-K filed on February 25, 2016 with the SEC.

Pursuant to Rule 13d-3 of the Act, the Reporting Persons may be deemed to beneficially own 3,623 common units and 28,753,623 subordinated units of the Issuer, which constitutes approximately 40.55% of the outstanding common units and subordinated units of the Issuer. The Reporting Person have shared power to vote or to direct the vote, and shared power to dispose or to direct the disposition of 3,623 common units and 28,753,623 subordinated units of the Issuer.

(c) Except as set forth in Item 3 above or elsewhere in this Schedule 13D, none of the Reporting Persons has effected any transaction in the Issuer s common units during the past 60 days.

(d) The Reporting Persons have the right to receive distributions from, and the proceeds from the sale of, the respective common units reported by such persons on the cover pages of this Schedule 13D and in this Item 5. See Schedule 1 for the information applicable to the Covered Persons. Except for the foregoing and the cash distribution described in Item 6 below, no other person is known by the Reporting Persons to have the right to receive or the power to direct the receipt of distributions from, or the proceeds from the sale of, common units beneficially owned by the Reporting Persons or, to the Reporting Persons knowledge, the Covered Persons.

(e) Not applicable.

Item 6. Contracts, Arrangements, Understandings or Relationships with Respect to Securities of the Issuer

Item 6 of the Schedule 13D is hereby amended and supplemented by the following:

The information set forth in or incorporated by reference in Items 2 and 4 of this Schedule 13D is incorporated by reference in its entirety into this Item 6.

In connection with the closing of the Private Placement, on February 22, 2016, (i) REA and the Purchasers entered into the Amended and Restated Limited Liability Company Agreement of Rice Midstream Holdings, which defines the preferences, rights, powers and duties of holders of the Series B Units (the LLC Agreement) and (ii) GP Management, as general partner of GP Holdings, and Rice Midstream Holdings and the Purchasers, as limited partners, entered into the Amended and Restated Agreement of Limited Partnership of GP Holdings, which defines the preferences, rights, powers and duties of holders of the GP Holdings Common Units (the GP Holdings A&R LPA).

LLC Agreement

Pursuant to the LLC Agreement, the Series B Units rank senior to all other equity interests in Rice Midstream Holdings with respect to the payment of distributions and distribution of assets upon liquidation, dissolution and winding up. The Series B Units will pay quarterly distributions at a rate of 8% per annum, payable in cash or additional Series B Units, subject to certain exceptions, at Rice Midstream Holdings option for the first two years, and in cash thereafter. The holders of Series B Units have the option to require Rice Midstream Holdings to redeem the Series B Units on or after the tenth anniversary of the Closing Date at an amount of $1,000 per Series B Unit plus any accrued and unpaid distributions (the Liquidation Preference). The Series B Units are subject to optional redemption by Rice Midstream Holdings after the third anniversary of the Closing Date, at a cash amount equal to the Liquidation Preference. If any of the Company, the MLP or Rice Midstream Holdings undergoes a Change in Control (as defined in the LLC Agreement), the Purchasers have the right to require Rice Midstream Holdings to repurchase any or all of the Series B Units for cash, and Rice Midstream Holdings has the right to repurchase any or all of the Series B Units for cash. The holders of the Series B units do not have the power to vote or dispose of the Issuer s units held by GP Holdings.

In the event that Rice Midstream Holdings or GP Holdings pursues an initial public offering, Rice Midstream Holdings may redeem the Series B Units at a redemption price equal to the Liquidation Preference on the date of the closing of the applicable initial public offering plus all additional distributions that would have otherwise been paid until the third anniversary of the Closing Date. Rice Midstream Holdings may satisfy this redemption price in cash or common equity interests of the applicable publicly traded entity at a 10% discount of the initial offering price to the public.

In the event of any liquidation and winding up of Rice Midstream Holdings, profits and losses will be allocated to the holders of the Series B Units so that, to the maximum extent possible, the capital accounts of the Series B unitholders will equal the aggregate Liquidation Preference.

GP Holdings A&R LPA

Pursuant to the GP Holdings A&R LPA, the holders of the GP Holdings Common Units are entitled to distributions of GP Holdings in proportion to their pro rata share of the outstanding GP Holdings Common Units, which distributions will occur upon the receipt by GP Holdings of any distributions of cash from the Issuer in respect of the equity interests in the Issuer held by GP Holdings.

The Purchasers holding GP Holdings Common Units will have tag-along rights in connection with a sale of the common equity interests in GP Holdings to a third-party purchaser. The holders of GP Holdings Common Units will have drag-along rights in connection with a sale of the majority of the common equity interests in GP Holdings to a third-party purchaser, subject to the achievement of an agreed-upon minimum return. If a qualifying initial public offering of GP Holdings is not consummated prior to the fifth anniversary of the Closing Date, the holders of the GP Holdings Common Units shall have the right to require GP Holdings to repurchase all of their GP Holdings Common Units for cash in an aggregate purchase price of $125.0 million. In the event of a Change in Control or a GP Change in Control (as each term is defined in the GP Holdings A&R LPA) of the Company, Rice Midstream Holdings or GP Holdings, the Purchasers shall have the right to require GP Holdings to repurchase all of their GP Holdings Common Units for an aggregate purchase price of $125.0 million. The holders of the GP Holdings Common Units do not have the power to vote or dispose of the Issuer s units held by GP Holdings.

In the event GP Holdings sells any of its assets, then, subject to certain exceptions, GP Holdings may only make distributions of such proceeds to the extent that GP Holdings meets certain requirements, including the requirement to retain a certain amount of cash or cash equivalents following the sale of such assets. In the event of any liquidation and winding up of GP Holdings, GP Management, in its capacity as general partner, will appoint a liquidator to wind up the affairs and make final distributions as provided for in the GP Holdings A&R LPA.

Item 7. Material to Be Filed as Exhibits

Exhibit A	Joint Filing Agreement (filed herewith).
Exhibit B	Amended and Restated Agreement of Limited Partnership of Rice Midstream Partners LP (incorporated by reference to Exhibit 3.1 to the Issuer s current report on Form 8-K (File No. 001-36789) filed with the Commission on December 22, 2014 and incorporated herein by reference).

Exhibit C	Amended and Restated Limited Liability Company Agreement of Rice Midstream Management LLC (incorporated by reference to Exhibit 3.2 to the Issuer s current report on Form 8-K (File No. 001-36789) filed with the Commission on December 22, 2014 and incorporated herein by reference).
Exhibit D	Registration Rights Agreement, dated as of December 22, 2014, by and between Rice Midstream Holdings LLC and Rice Midstream Partners LP. (incorporated by reference to Exhibit 10.5 of the Issuer s Current Report on Form 8-K (File No. 001-36789) filed with the Commission on December 22, 2014).
Exhibit E	Amended and Restated Agreement of Limited Partnership of Rice Midstream GP Holdings LP (filed herewith).
Exhibit F	Amended and Restated Limited Liability Company Agreement of Rice Midstream Holdings LLC (filed herewith).

SIGNATURE

After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

Dated: March 7, 2016

RICE ENERGY INC.

/s/ William E. Jordan
Name: William E. Jordan
Title: Senior Vice President, General Counsel and Corporate Secretary

RICE ENERGY APPALACHIA, LLC

/s/ William E. Jordan
Name: William E. Jordan
Title: Senior Vice President, General Counsel and Corporate Secretary

RICE MIDSTREAM HOLDINGS LLC

/s/ William E. Jordan
Name: William E. Jordan
Title: Senior Vice President, General Counsel and Corporate Secretary

RICE MIDSTREAM GP MANAGEMENT LLC

/s/ William E. Jordan
Name: William E. Jordan
Title: Manager

RICE MIDSTREAM GP HOLDINGS LP

By: Rice Midstream GP Management LLC

/s/ William E. Jordan
Name: William E. Jordan
Title: Manager

SCHEDULE I

The name and business address of each of the executive officers and directors of Rice Midstream GP Holdings LP, Rice Midstream GP Management LLC, Rice Midstream Holdings LLC, Rice Energy Appalachia, LLC, and Rice Energy Inc. are also set forth below (outside of similar positions held with respect to other entities directly or indirectly managed or advised by the Issuer, Rice Midstream GP Holdings LP, Rice Midstream Management GP LLC, Rice Midstream Holdings LLC, Rice Energy Appalachia, LLC or Rice Energy Inc.).

Officers of Rice Midstream Holdings LLC

Daniel J. Rice IV

c/o Rice Energy Inc.

400 Woodcliff Drive, Canonsburg, Pennsylvania 15317

Principal Occupation: Chief Executive Officer of Rice Energy Inc. and Chief Executive Officer of Rice Midstream

Management LLC

Citizenship: USA

Amount Beneficially Owned: 16,152 common units

Toby Z. Rice

c/o Rice Energy Inc.

400 Woodcliff Drive, Canonsburg, Pennsylvania 15317

Principal Occupation: President and Chief Operating Officer of Rice Energy Inc.

Citizenship: USA

Amount Beneficially Owned: 27,652 common units

Derek A. Rice

c/o Rice Energy Inc.

400 Woodcliff Drive, Canonsburg, Pennsylvania 15317

Principal Occupation: Executive Vice President of Exploration & Geology of Rice Energy Inc.

Citizenship: USA

Amount Beneficially Owned: 15,152 common units

Grayson T. Lisenby

c/o Rice Energy Inc.

400 Woodcliff Drive, Canonsburg, Pennsylvania 15317

Principal Occupation: Senior Vice President and Chief Financial Officer of Rice Energy Inc., Vice President and Chief Financial Officer of Rice Midstream Management LLC and Manager of Rice Midstream GP Management LLC

Citizenship: USA

Amount Beneficially Owned: 31,152 common units

James W. Rogers

c/o Rice Energy Inc.

400 Woodcliff Drive, Canonsburg, Pennsylvania 15317

Principal Occupation: Senior Vice President, Chief Accounting & Administrative Officer, Treasurer of Rice Energy Inc. and Vice President, Chief Accounting & Administrative Officer, Treasurer of Rice Midstream Management LLC

Citizenship: USA

Amount Beneficially Owned: 25,152 common units

William E. Jordan

c/o Rice Energy Inc.

400 Woodcliff Drive, Canonsburg, Pennsylvania 15317

Principal Occupation: Senior Vice President, General Counsel and Corporate Secretary of Rice Energy Inc., Vice President, General Counsel and Corporate Secretary of Rice Midstream Management LLC and Manager of Rice Midstream GP Management LLC

Citizenship: USA

Amount Beneficially Owned: 29,243 common units

Robert R. Wingo

c/o Rice Energy Inc.

400 Woodcliff Drive, Canonsburg, Pennsylvania 15317

Principal Occupation: Senior Vice President, Midstream & Marketing of Rice Energy Inc., Senior Vice President, Chief Operating Officer of Rice Midstream Management LLC and Manager of Rice Midstream GP Management LLC

Citizenship: USA

Amount Beneficially Owned: 36,743 common units

Officers of Rice Energy Appalachia, LLC

Daniel J. Rice IV

(see above)

Toby Z. Rice

(see above)

Derek A. Rice

(see above)

Grayson T. Lisenby

(see above)

James W. Rogers

(see above)

William E. Jordan

(see above)

Robert R. Wingo

(see above)

Officers of Rice Energy Inc.

Daniel J. Rice IV

(see above)

Toby Z. Rice

(see above)

Derek A. Rice

(see above)

Grayson T. Lisenby

(see above)

James W. Rogers

(see above)

William E. Jordan

(see above)

Robert R. Wingo

(see above)

Directors of Rice Energy Inc.

Daniel J. Rice IV

(see above)

Toby Z. Rice

(see above)

Robert F. Vagt

c/o Rice Energy Inc.

400 Woodcliff Drive, Canonsburg, Pennsylvania 15317

Principal Occupation: Director of Rice Midstream Management LLC and Director of Rice Energy Inc.

Citizenship: USA

Amount Beneficially Owned: 0 common units

Daniel J. Rice III

c/o Rice Energy Inc.

400 Woodcliff Drive, Canonsburg, Pennsylvania 15317

Principal Occupation: Director of Rice Midstream Management LLC and Director of Rice Energy Inc.

Citizenship: USA

Amount Beneficially Owned: 0 common units

Scott A. Gieselman

c/o Rice Energy Inc.

400 Woodcliff Drive, Canonsburg, Pennsylvania 15317

Principal Occupation: Director of Rice Energy Inc.

Citizenship: USA

Amount Beneficially Owned: 0 common units

James W. Christmas

c/o Rice Energy Inc.

400 Woodcliff Drive, Canonsburg, Pennsylvania 15317

Principal Occupation: Director of Rice Energy Inc.

Citizenship: USA

Amount Beneficially Owned: 19,546 common units

Steven C. Dixon

c/o Rice Energy Inc.

400 Woodcliff Drive, Canonsburg, Pennsylvania 15317

Principal Occupation: Director of Rice Energy Inc.

Citizenship: USA

Amount Beneficially Owned: 1,000 common units

John McCartney

c/o Rice Energy Inc.

400 Woodcliff Drive, Canonsburg, Pennsylvania 15317

Principal Occupation: Director of Rice Energy Inc.

Citizenship: USA

Amount Beneficially Owned: 0 common units

Officers of Rice Midstream GP Holdings LP

None.

Officers of Rice Midstream GP Management LLC

None.

Managers of Rice Midstream GP Management LLC

William E. Jordan

(see above)

Grayson T. Lisenby

(see above)

Robert R. Wingo

(see above)

tyle="border-top: 1px solid #000000"> $ 6,570

Acquisition of ART Advanced Recognition Technologies, Inc. (ART)

On January 21, 2005, the Company acquired all of the outstanding capital stock of ART, a company which designs, develops and sells speech and handwriting recognition software products. With the acquisition of ART, the Company expanded its portfolio of embedded speech solutions to include a deep set of resources, expertise and relationships with the world s leading mobile device manufacturers and service providers. ART specializes in applications that create voice-based, conversational interfaces that enable users to dial by voice and manage and access their contacts for mobile devices.

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The total purchase price of approximately $27.7 million consisted of first cash installment payment of $10.0 million paid at closing, a deferred payment of $16.4 million to be paid in December 2005 plus interest of 4%, and $1.3 million of transaction costs. During fiscal 2006, the Company paid $14.4 million of the deferred payment. As of September 30, 2006, the Company still had an outstanding purchase price payment of $2.0 million which represents proceeds withheld by the Company to satisfy claims against the former ART shareholders under the purchase agreement. Subsequent to September 30, 2006, the Company agreed to pay the former ART shareholders $1.0 million and retained the remaining amount in full satisfaction of the claims made against the former ART shareholders and will be used by the Company, if necessary, to satisfy the liabilities that formed the basis of the claims against the former ART shareholders. The merger was a taxable event and has been accounted under the purchase method of accounting. The results of operations of the acquired business have been included in the consolidated financial statements of the Company since the date of acquisition. The following table summarizes the final allocation of the purchase price (in thousands):

Total purchase consideration:	
Cash	$ 26,414
Transaction costs	1,306
Total purchase consideration	$ 27,720
Allocation of the purchase consideration:	
Current assets	$ 5,546
Property and equipment	769
Other assets	486
Identifiable intangible assets	9,380
Goodwill	19,064
Total assets acquired	35,245
Current liabilities	(3,234)
Long-term liabilities	(4,291)
Total liabilities assumed	(7,525)
Net assets acquired	$ 27,720

Customer relationships are amortized based upon patterns in which the economic benefits of customer relationships are expected to be utilized. Other finite-lived identifiable intangible assets are amortized on a straight-line basis. The following are the identifiable intangible assets acquired and their respective weighted average lives (dollars in thousands):

Weighted

	Amount	Average Life (In years)
Core and completed technology	$ 5,150	6.9
Customer relationships	4,210	8.0
Non-compete agreements	20	1.0
	$ 9,380	

Acquisition of Rhetorical Systems, Ltd. (Rhetorical)

On December 6, 2004, the Company acquired all of the outstanding capital stock of Rhetorical, a supplier of innovative text-to-speech solutions and tools based in Edinburgh, Scotland. With the acquisition of

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Rhetorical, the Company solidified its position as a leading provider of speech synthesis or text-to-speech solutions for a variety of speech-based applications. The Rhetorical acquisition further differentiates the Company s solutions with a number of techniques, tools, and services that enhance the ability to deliver custom, dynamic voices.

The consideration consisted of 2.8 million Pounds Sterling in cash (valued at $5.4 million using foreign exchange rates as of the date of the acquisition) and 449,437 shares of the Company s common stock valued at $1.7 million. The acquisition is a taxable event and has been accounted for under the purchase method of accounting. The results of operations of the acquired business have been included in the consolidated financial statements of the Company since the date of acquisition. The following table summarizes the final allocation of the purchase price (in thousands):

Total purchase consideration:		
Cash	$	5,360
Common stock issued		1,672
Transaction costs		1,091
Total purchase consideration	$	8,123
Allocation of the purchase consideration:		
Current assets	$	824
Property and equipment		153
Identifiable intangible assets		1,310
Goodwill		9,300
Total assets acquired		11,587
Current liabilities		(2,518)
Long-term liabilities		(946)
Total liabilities assumed		(3,464)
Net assets acquired	$	8,123

In connection with the acquisition of Rhetorical, the Company closed a facility in Edinburgh, Scotland and recognized $1.3 million in liabilities at date of acquisition for the remaining contractual obligations associated with the closed facility in accordance with EITF 95-3.

Customer relationships are amortized based upon patterns in which the economic benefits of customer relationships are expected to be utilized. Other finite-lived identifiable intangible assets are amortized on a straight-line basis. The following are the identifiable intangible assets acquired and their respective weighted average lives (dollars in thousands):

	Amount	Weighted Average Life (In years)
Core and completed technology	$ 490	10.0
Customer relationships Maintenance	690	8.0
Customer relationships License and Professional Services	100	0.3
Non-compete agreements	30	1.0
	$ 1,310	

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Acquisition of Brand & Groeber Communications GbR (B&G)

On September 16, 2004, the Company acquired all of the outstanding capital stock of B&G, to expand its intellectual property portfolio relating to embedded speech synthesis technology. B&G s embedded speech application makes mobile phones accessible to the visually impaired. Many of the application s standard features, like email reading, have broad applicability for all types of users where eyes-free use of mobile devices is important, like in the automobile. The total purchase price of approximately $0.6 million consisted of cash consideration of $0.5 million and transaction costs of $0.1 million. Under the agreement, the Company agreed to make maximum additional payments of up to 5.5 million upon achievement of certain established financial targets. From the date of acquisition through December 31, 2005, 0.4 million was paid based on the attainment of certain performance targets. The remaining 5.1 million (approximately $6.5 million based on the currency exchange rates as of September 30, 2006) may be earned based on the attainment of performance targets for calendar 2006 and, to the extent earned, would be paid in January 2007. Any additional payments related to this contingency will be accounted for as additional goodwill. The acquisition has been accounted for under the purchase method of accounting and was taxable to the shareholders. The results of operations of the acquired business have been included in the financial statements of the Company since the date of acquisition.

Identifiable intangible assets with finite lives are amortized on a straight-line basis. The following are the identifiable intangible assets acquired and their respective weighted average lives (dollars in thousands):

	Amount	Weighted Average Life (In years)
Completed technology	$ 80	5.0
Customer relationships	180	8.0
Trade names and trademarks	20	8.0
	$ 280	

Acquisition of Telelogue, Inc. (Telelogue)

On June 15, 2004, the Company acquired all of the outstanding capital stock of Telelogue, a provider of automated directory assistance applications for telecommunications providers, based in New Jersey. The acquisition of Telelogue enhanced the Company s automated directory assistance portfolio by adding key customer and partner relationships, methodologies in voice user interface, and several patents used in the successful automation of directory automation services.

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The total purchase price of approximately $3.3 million included cash consideration equal to $2.2 million, transaction costs of $0.8 million and the assumption of certain obligations of $0.3 million. The merger was a taxable event and had been accounted for under the purchase method of accounting. An additional amount of $2.0 million in contingent consideration was not earned during the period defined in the purchase agreement, and will not become payable. The results of operations of the acquired business have been included in the consolidated financial statements of the Company since the date of acquisition. The following table summarizes the final allocation of the purchase price (in thousands):

Total purchase consideration:	
Cash	$ 2,206
Debt assumed	297
Transaction costs	832
Total purchase consideration	$ 3,335
Allocation of the purchase consideration:	
Current assets	$ 305
Property and equipment	637
Identifiable intangible assets	550
Goodwill	2,923
Total assets acquired	4,415
Current liabilities	(592)
Long-term liabilities	(488)
Total liabilities assumed	(1,080)
Net assets acquired	$ 3,335

Identifiable intangible assets with finite lives are amortized on a straight-line basis. The following are the identifiable intangible assets acquired and their respective weighted average lives (dollars in thousands):

	Amount	Weighted Average Life (In years)
Core technology	$ 220	7.0
Completed technology	90	3.0
Trade names and trademarks	240	4.0

$	550

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Marketable Securities

The Company accounts for its marketable equity securities in accordance with SFAS 115, Accounting for Certain Investments in Debt and Equity Securities. Investments are classified as available-for-sale and are recorded on the balance sheet at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income (losses), net of tax. Realized gains and losses on sales of short-term and long-term investments have not been material. Marketable securities have been classified as available-for-sale securities as follows (in thousands):

	Cost	Net Unrealized Gains (Losses)	Estimated Fair Value
Balance at September 30, 2005			
U.S. government agencies	$ 7,333	$ 3	$ 7,336
Corporate notes	16,836	(45)	16,791
Total short-term marketable securities	$ 24,169	$ (42)	$ 24,127

As of September 30, 2006, the Company did not have any outstanding marketable securities.

5. Accounts Receivable

Accounts receivable, excluding acquired unbilled accounts receivable, consisted of the following (in thousands):

	September 30, 2006	September 30, 2005
Accounts receivable	$ 116,574	$ 62,212
Unbilled accounts receivable	12,405	17,394
	128,979	79,606
Less allowance for doubtful accounts	(2,100)	(2,995)
Less reserve for distribution and reseller accounts receivable	(9,797)	(5,798)
Less allowance for sales returns	(6,304)	(4,325)
	$ 110,778	$ 66,488

Unbilled accounts receivable primarily relate to product revenue earned under royalty-based arrangements for which billing occurs in the month following receipt of the royalty report, and for professional services revenue earned under percentage of completion contracts that have not yet been billed based on the terms of the specific arrangement.

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Activities in the allowance for doubtful accounts and other sales reserves were as follows (in thousands):

	Allowance for Doubtful accounts	Reserve for Distribution and Reseller	Allowances for Sales Returns
Balance at December 31, 2003	$ 1,439	$ 5,891	$ 2,870
Additions charged to costs and expenses	1,286		
Write-offs, net of recoveries	(243)		
Reductions (additions) made to revenue, net		9	56
Balance at September 30, 2004	2,482	5,900	2,926
Additions charged to costs and expenses	1,310		
Write-offs, net of recoveries	(797)		
Reductions (additions) made to revenue, net		(102)	1,399
Balance at September 30, 2005	2,995	5,798	4,325
Additions charged to costs and expenses	1,407		
Write-offs, net of recoveries	(2,302)		
Reductions (additions) made to revenue, net		3,999	1,979
Balance at September 30, 2006	$ 2,100	$ 9,797	$ 6,304

Acquired unbilled accounts receivable consist of amounts established under the provisions of EITF 01-3 and relate to future expected billings of certain non-cancelable contracts which have been assumed by the Company in connection with its accounting for acquisitions. To the extent that the products or services deliverable under these contracts were not delivered as of the date of the acquisition, and therefore represent an assumed legal performance obligation by the Company. An asset is recorded for payments due from customers, and a related liability for the fair value of undelivered services is included in unearned revenue and customer deposits relating to such future recognizable revenue. As of September 30, 2006 and 2005, the acquired unbilled accounts receivable were approximately $19.7 million and $3.1 million, respectively. The increase is attributable to the acquisition of Dictaphone in March 2006 (Note 3).

6. Inventories, net

Inventories, net of allowances, consisted of the following (in thousands):

	September 30, 2006	September 30, 2005

Components and parts	$	3,249	$	
Inventory at customers		2,317		
Finished products		1,229		313
	$	6,795	$	313

Inventory at customers reflects equipment related to in-process installations of solutions of Dictaphone contracts with customers. These contracts have not been recorded to revenue as of September 30. 2006, and therefore the inventory is on the balance sheet until such time as the contract is recorded to revenue and the inventory will be expensed to cost of sales.

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Land, Building and Equipment, Net

Land, building and equipment, net at September 30, 2006 and 2005 were as follows (in thousands):

	Useful Life (In years)	September 30, 2006	September 30, 2005
Land		$ 2,400	$
Building	30	4,800	
Machinery & equipment	3-5	1,605	
Computers, software and equipment	3-5	30,613	21,850
Leasehold improvements	2-10	7,076	4,932
Furniture and fixtures	5	5,217	4,432
Construction in process		3,143	30
Subtotal		54,854	31,244
Less: Accumulated depreciation		(24,154)	(16,911)
Land, building and equipment, net		$ 30,700	$ 14,333

Depreciation expense, associated with building and equipment, for fiscal 2006, 2005 and 2004 was $8.4 million, $5.0 million and $2.9 million, respectively. Construction in progress is related to the capitalization of internal costs associated with various projects relating to financial systems. The projects are expected to cost an additional approximately $3.3 million to complete, and will be placed into service in fiscal 2007.

8. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for fiscal years 2006 and 2005, are as follows (in thousands):

Balance as of September 30, 2004	$ 246,424
Goodwill acquired	218,119
Purchase accounting adjustments	(4,720)
Effect of foreign currency translation	(1,510)
Balance as of September 30, 2005	458,313
Goodwill acquired Dictaphone acquisition	239,174
Purchase accounting adjustments	(2,547)
Effect of foreign currency translation	4,393

Balance as of September 30, 2006	$ 699,333

Goodwill adjustments during fiscal 2006 primarily included $7.9 million of the utilization of acquired deferred tax assets in connection with the acquisition of SpeechWorks, Inc. in 2003 and Former Nuance in 2005 as well as $0.8 million final purchase price allocations in connection with various acquisitions during fiscal 2005. These adjustments were partially offset by the inclusion of an additional $5.8 million of pre-acquisition contingencies due to minimum committed royalties in connection with the acquisitions of ART and Phonetic, and $0.3 million of additional transaction costs.

Goodwill adjustments during fiscal 2005 primarily included $2.8 million and $1.8 million of the utilization of acquired deferred tax assets in connection with the acquisition of Speechworks, Inc. in 2003 and Caere Corporation in 2000, respectively and $0.1 million related to final purchase price allocations in connection with the acquisitions made during fiscal 2004.

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Intangible assets consist of the following (in thousands):

	At September 30, 2006			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Remaining Life (Years)
Customer relationships	$ 147,814	$ 20,721	$ 127,093	8.7
Technology and patents	91,033	30,897	60,136	6.0
Tradenames and trademarks, subject to amortization	8,750	4,092	4,658	5.9
Non-competition agreement	588	235	353	3.3
Subtotal	248,185	55,945	192,240	
Tradename, indefinite life	27,800		27,800	n/a
Total	$ 275,985	$ 55,945	$ 220,040	

	At September 30, 2005			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Remaining Life (Years)
Customer relationships	$ 41,567	$ 5,701	$ 35,866	5.6
Technology and patents	67,832	16,771	51,061	7.7
Tradenames and trademarks	8,090	3,132	4,958	9.1
Non-competition agreement	557	92	465	4.7
Total	$ 118,046	$ 25,696	$ 92,350	

On March 31, 2003, the Company entered into an agreement with a counter party that grants an exclusive license to the Company to resell the counter party s productivity application. The Company capitalized $11.4 million as completed technology and has amortized the amount to cost of revenue on a straight-line basis over the period of expected use of five years. During the fourth quarter of fiscal 2006, the Company determined it would not make additional investments to support this technology. As a result, the Company revised its cash flow estimates related to the acquired technology and recorded an additional $2.6 million in cost of revenue to write down the purchased technology to its net realizable value at September 30, 2006. Total net book value of the asset was $0.5 million and $5.2 million as of September 30, 2006 and 2005, respectively.

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Amortization expense for the acquired patents, core and completed technology are included in the cost of revenue from amortization of intangible assets in the accompanying Statements of Operations amounted to $12.9 million, $9.2 million and $8.4 million in fiscal 2006, 2005 and 2004, respectively. Amortization expense included in operating expenses was $17.2 million, $4.0 million and $2.0 million in fiscal 2006, 2005 and 2004, respectively. Estimated amortization expense for each of the five succeeding years as of September 30, 2006, is as follows (in thousands):

Year Ending September 30,	Cost of Revenue	Other Operating Expenses	Total
2007	$ 11,217	$ 20,369	$ 31,586
2008	10,565	18,922	29,487
2009	9,745	17,045	26,790
2010	8,960	14,832	23,792
2011	8,542	13,639	22,181
Thereafter	11,107	47,297	58,404
Total	$ 60,136	$ 132,104	$ 192,240

9. Accrued Expenses

Accrued expenses consisted of the following (in thousands):

	September 30, 2006	September 30, 2005
Accrued compensation	$ 21,310	$ 13,911
Accrued sales and marketing incentives	4,454	2,994
Accrued restructuring and other charges	904	5,805
Accrued professional fees	3,823	6,169
Accrued acquisition costs and liabilities	747	18,233
Income taxes payable	3,857	1,525
Accrued other	17,579	11,516
	$ 52,674	$ 60,153

Accrued acquisition costs and liabilities at September 30, 3006 primarily related to the acquisition of Dictaphone on March 31, 2006. Accrued acquisition costs and liabilities at September 30, 2005 included $12.0 million for costs to consummate the acquisition of Former Nuance and $6.2 million payable to shareholders of Former Nuance.

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Debt

At September 30, 2006 and 2005, the Company had the following borrowing obligations (in thousands):

	September 30, 2006	September 30, 2005
2006 Credit Facility	$ 353,225	$
2003 0% Convertible Debenture		27,524
2002 Credit Facility		
Obligations under capital leases	718	222
	353,943	27,746
Less: current portion	3,953	27,711
	$ 349,990	$ 35

2006 Credit Facility

On March 31, 2006 the Company entered into a new senior secured credit facility (the 2006 Credit Facility). The 2006 Credit Facility consists of a $355.0 million 7-year term loan which matures on March 31, 2013 and a $75.0 million revolving credit line which matures on March 31, 2012. The available revolving credit line capacity is reduced, as necessary, to account for certain letters of credit outstanding. As of September 30, 2006, there were $17.2 million of letters of credit issued under the revolving credit line and there were no other outstanding borrowings under the revolving credit line.

Borrowings under the 2006 Credit Facility bear interest at a rate equal to the applicable margin plus, at the Company s option, either (a) a base rate (which is the higher of the corporate base rate of UBS AG, Stamford Branch, or the federal funds rate plus 0.50% per annum) or (b) a LIBOR rate determined by reference to the British Bankers Association Interest Settlement Rates for deposits in U.S. dollars. The applicable margin for borrowings under the 2006 Credit Facility ranges from 0.50% to 1.00% per annum with respect to base rate borrowings and from 1.50% to 2.00% per annum with respect to LIBOR-based borrowings, depending upon the Company s leverage ratio. As of September 30, 2006, the Company s applicable margin is 1.00% for base rate borrowings and 2.00% for LIBOR-based borrowings. The Company is required to pay a commitment fee for unutilized commitments under the revolving credit facility at a rate ranging from 0.375% to 0.50% per annum, based upon our leverage ratio. As of September 30, 2006, the commitment fee rate is 0.50%.

The Company capitalized approximately $9.0 million in debt issuance costs related to the opening of the 2006 Credit Facility. The costs associated with the revolving credit facility are being amortized as interest expense over six years, through March 2012, while the costs associated with the term loan are being amortized as interest expense over seven years, through March 2013, which are the maturity dates of the revolving line and term facility, respectively under the 2006 Credit Facility. The effective interest method is used to calculate the amortization of the debt issuance costs for both the revolving credit facility and the term loan. These debt issuance costs, net of accumulated amortization of $0.7 million, are included in other assets in the consolidated balance sheet as of September 30, 2006.

The $355.0 million term loan is subject to repayment consisting of a baseline amortization of 1% per annum ($3.55 million per year, due in four equal quarterly installments), and an annual excess cash flow sweep, as defined in the 2006 Credit Facility, which will be first payable beginning in the first quarter of fiscal 2008, based on the excess cash flow generated in fiscal 2007. As of September 30, 2006, we have repaid $1.8 million of principal under the term loan agreement. Any borrowings not paid through the baseline repayment, the excess cash flow sweep, or any other mandatory or optional payments that the Company may

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

make, will be repaid upon maturity. If only the baseline repayments are made, the aggregate annual maturities of the term loan would be as follows (in thousands):

Year Ending September 30,	Amount
2007	$ 3,550
2008	3,550
2009	3,550
2010	3,550
2011	3,550
Thereafter	335,475
Total	$ 353,225

The Company s obligations under the 2006 Credit Facility are unconditionally guaranteed by, subject to certain exceptions, each of its existing and future direct and indirect wholly-owned domestic subsidiaries. The 2006 Credit Facility and the guarantees thereof are secured by first priority liens and security interests in the following: 100% of the capital stock of substantially all of the Company s domestic subsidiaries and 65% of the outstanding voting equity interests and 100% of the non-voting equity interests of first-tier foreign subsidiaries, material tangible and intangible assets, and present and future intercompany debt. The 2006 Credit Facility also contains provisions for mandatory prepayments of outstanding term loans, subject to certain exceptions, with: 100% of net cash proceeds of asset sales, 100% of net cash proceeds of issuance or incurrence of debt, and 100% of extraordinary receipts. The Company may voluntarily prepay the 2006 Credit Facility without premium or penalty other than customary breakage costs with respect to LIBOR-based loans.

The 2006 Credit Facility agreement contains a number of covenants that, among other things, restrict, subject to certain exceptions, the ability of the Company and its subsidiaries to: incur additional indebtedness, create liens on assets, enter into certain sale and lease-back transactions, make investments, make certain acquisitions, sell assets, engage in mergers or consolidations, pay dividends and distributions or repurchase the Company s capital stock, engage in certain transactions with affiliates, change the business conducted by the Company and its subsidiaries, amend certain charter documents and material agreements governing subordinated indebtedness, prepay other indebtedness, enter into agreements that restrict dividends from subsidiaries and enter into certain derivatives transactions. The 2006 Credit Facility is governed by financial covenants that include, but are not limited to, maximum total leverage and minimum interest coverage ratios, as well as to a maximum capital expenditures limitation. The 2006 Credit Facility also contains certain customary affirmative covenants and events of default. As of September 30, 2006, the Company was in compliance with the covenants under the 2006 Credit Facility agreement.

2002 Credit Facility

The Company historically maintained a Loan and Security Agreement (the 2002 Credit Facility) with Silicon Valley Bank which was initiated on October 31, 2002, and was amended several times, most recently in December 2005. The agreement consisted of a $10.0 million revolving loan which expired on March 31, 2006.

The Company was required to comply with both a minimum adjusted quick ratio and a minimum tangible net worth calculation, as defined in the agreement. Depending on the Company s adjusted quick ratio, borrowings under the Credit Facility bore interest at the prime rate plus up to 0.75%, (collectively 6.75% at September 30, 2005). Borrowings under the 2002 Credit Facility were collateralized by substantially all of the Company s personal property, predominantly its accounts receivable, but not its intellectual property. As of

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2005, no amounts were outstanding under the Credit Facility and $6.1 million committed for outstanding letters of credit.

2003 0% Convertible Debenture

On January 30, 2003, the Company issued a $27.5 million three-year, zero-interest convertible subordinated debenture due January 2006 to Royal Philips Electronics Speech Processing Technology and Voice Control business unit (Philips) as partial consideration for certain assets the Company acquired from Philips. The convertible note was convertible into shares of the Company s common stock at $6.00 per share at any time until maturity at Philips option. The convertible note contained a provision that all amounts unpaid at maturity bear interest at a rate of 3% per quarter until paid. On January 30, 2006, Philips exercised its right to convert the note into 4,587,334 shares of the Company s common stock at the conversion price of $6.00 per share, in full satisfaction of all amounts due.

11. Financial Instruments and Hedging Activities

On March 31, 2006, the Company entered into a three-year interest rate swap with a notional value of $100 million (the Interest Rate Swap). The Interest Rate Swap was entered into as a partial hedge of the 2006 Credit Facility, discussed in Note 10, to effectively change the characteristics of the interest rate without actually changing the debt instrument. For floating rate debt, interest rate changes generally do not affect the fair market value, but do impact future earnings and cash flows, assuming other factors are held constant. At its inception, the Company formally documented the hedging relationship and has determined that the hedge is perfectly effective and designated it as a cash flow hedge of a portion of the 2006 Credit Facility as defined by SFAS 133. The Interest Rate Swap will hedge the variability of the cash flows caused by changes in U.S. dollar LIBOR interest rates. The swap is marked to market at each reporting date. The fair value of the Interest Rate Swap at September 30, 2006 was $0.6 million which was included in other liabilities. Changes in the fair value of the cash flow hedge derivative are reported in stockholders equity as a component of accumulated other comprehensive income (loss).

12. Accrued Business Combination Costs

In connection with the acquisitions of SpeechWorks International, Inc. in August 2003 and Former Nuance in September 2005, the Company has assumed obligations relating to certain leased facilities expiring in 2016 and 2012, respectively, and that were abandoned by the acquired companies prior to the acquisition date. The fair value of the obligations, net of estimated sublease income, are recognized as liabilities assumed by the Company and accordingly are included in the allocation of the purchase price, generally resulting in an increase to the recorded amount of the goodwill. The net payments have been discounted in calculating the fair value of the obligation as of the date of acquisition, and the discount is being accreted through expected maturity. As of September 30, 2006, the total gross payments due from the Company to the landlords of the facilities is $88.9 million. This is reduced by $17.4 million of sublease income and a $6.5 million present value discount. The gross value of the lease exit costs will be paid out approximately as follows: $12.4 million in fiscal 2007, $12.8 million in fiscal 2008, $13.2 million in fiscal 2009, $13.6 million in fiscal 2010, $14.2 million in fiscal 2011, and $22.8 million from fiscal 2012 through fiscal 2016. These gross payment obligations are included in the commitments disclosed in Note 17.

Additionally, the Company has implemented restructuring plans to eliminate duplicate facilities, personnel or assets in connection with the business combinations. In accordance with EITF 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination, costs such as these are recognized as liabilities assumed by the Company, and accordingly are included in the allocation of the purchase price, generally resulting in an increase to the recorded amount of the goodwill. As of September 30, 2006, total gross payments due from the Company to the landlords of the facilities is $3.4 million. This is reduced by

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

$1.1 million sublease income. The gross value of the lease exit costs will be paid out approximately as follows: $1.5 million in fiscal 2007, $1.0 million in fiscal 2008 and $0.9 million in fiscal 2009. These gross payment obligations are included in the commitments disclosed in Note 17.

As noted in Note 3, in addition to the facilities accruals, the Company has an obligation relating to certain incentive compensation payments to former employees of the acquired companies whose positions have been eliminated in connection with the combinations. The remaining payments for these obligations are expected to be made in fiscal 2007.

The components of these accrued business combination costs are as follows (in thousands):

	Facilities	Personnel	Total
Balance at September 30, 2004	$ 14,948	$	$ 14,948
Charged to goodwill	56,189	3,523	59,712
Charged to interest expense	281		281
Cash payments, net of sublease receipts	(1,555)	(1,387)	(2,942)
Balance at September 30, 2005	69,863	2,136	71,999
Charged to goodwill	802	1,721	2,523
Charged to interest expense	2,332		2,332
Cash payments, net of sublease receipts	(13,776)	(3,013)	(16,789)
Balance at September 30, 2006	$ 59,221	$ 844	$ 60,065

13. Restructuring and Other Charges, net

Fiscal 2006

In fiscal 2006, the Company recorded a recovery of $1.2 million from restructuring and other charges. The recovery consisted of $1.3 million reduction to existing restructuring reserves as a result of a favorable sublease agreement signed during the second quarter of fiscal 2006. The amount was offset by net adjustments of $0.1 million associated with prior years restructuring programs.

Fiscal 2005

In fiscal 2005, the Company incurred restructuring charges of $7.2 million. In the first quarter of fiscal 2005, a plan of restructuring relating to the elimination of ten employees was enacted. In June 2005, the Company initiated the process of consolidating certain operations into its new corporate headquarters facility in Burlington, Massachusetts. In addition, at various times during the third fiscal quarter, the Company committed to pursuing the closure and consolidation of certain other domestic and international facilities. As a result of these initiatives, the Company recorded restructuring charges in its third fiscal quarter totaling approximately $2.1 million. In September 2005, in connection with the acquisition of Former Nuance, the Company committed to a plan of restructuring of certain of its personnel and facilities. Under this plan of restructuring, the Company accrued $2.5 million relating to the elimination of approximately 40 personnel, mainly in research and development and sales and marketing; additionally, certain of its facilities were selected to be closed, resulting in an accrual of $2.0 million for future committed facility lease payments, net of assumed sublease income, and $0.2 in property and equipment were written off. The restructuring charge taken in the fourth quarter of fiscal 2005 was related to only the Company s historic personnel and facilities. Any personnel or facilities-related restructuring activities in connection with the acquisition of Former Nuance were accrued as assumed liabilities in purchase accounting.

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fiscal 2004

During the three months ended March 31, 2004, the Company recorded a charge of $0.8 million related to separation agreements with two former members of its senior management team.

The following table sets forth the fiscal 2006, 2005 and 2004 accrual activity relating to restructuring and other charges (in thousands):

	Personnel	Facilities	Asset Impairment	Total
Balance at December 31, 2003	$ 1,552	$ 309	$	$ 1,861
Restructuring and other charges	801			801
Non-cash write-off	(348)			(348)
Cash payments	(1,599)	(141)		(1,740)
Balance at September 30, 2004	406	168		574
Restructuring and other charges	2,928	4,083	212	7,223
Non-cash write-off			(212)	(212)
Cash payments	(1,548)	(232)		(1,780)
Balance at September 30, 2005	1,786	4,019		5,805
Restructuring and other charges	(52)	(1,181)		(1,233)
Cash payments	(1,360)	(2,308)		(3,668)
Balance at September 30, 2006	$ 374	$ 530	$	$ 904

The remaining personnel-related accrual as of September 30, 2006 is primarily comprised of amounts due under the restructuring charge from the fourth quarter of fiscal 2005, the balance of which will be paid in fiscal 2007. The personnel-related payments made in fiscal 2006 were primarily related to the charges recorded in the fourth quarter of fiscal 2005.

14. Supplemental Cash Flow Information

Cash paid for Interest and Income Taxes:

During fiscal 2006, 2005 and 2004, the Company made cash payments for interest totaling $13.8 million, $0.6 million and $0.2 million, respectively.

During fiscal 2006, 2005 and 2004, total net cash paid (refunds) for income taxes were $3.4 million, $(0.7) million and $0.6 million, respectively.

Non Cash Investing and Financing Activities:

In January, 2006, the Company issued 4,587,334 shares of its common stock valued at $27.5 million upon conversion of the $27.5 million convertible debenture.

In September 2005, the Company issued 28,760,031 shares of its common stock valued at $117.9 million in connection with the acquisition of Former Nuance. The Company also assumed stock options valued at $14.7 million.

In June 2005, the Company issued 1,544,228 shares of its common stock valued at $6.5 million in connection with the acquisition of MedRemote.

In June 2005, in connection with the acquisition of Phonetic, the Company issued warrants for the purchase of up to 750,000 shares of its common stock, these warrants were valued at $0.4 million.

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In December 2004, the Company issued 449,437 shares of its common stock valued at $1.7 million in connection with the acquisition of Rhetorical.

15. Stockholders Equity

Preferred Stock

The Company is authorized to issue up to 40,000,000 shares of preferred stock, par value $0.001 per share. The Company has designated 100,000 shares as Series A Preferred Stock and 15,000,000 shares as Series B Preferred Stock. In connection with the acquisition of ScanSoft from Xerox Corporation (Xerox), the Company issued 3,562,238 shares of Series B Preferred Stock to Xerox. On March 19, 2004, the Company announced that Warburg Pincus, a global private equity firm, had agreed to purchase all outstanding shares of the Company s stock held by Xerox Corporation for approximately $80 million, including the 3,562,238 shares of Series B Preferred Stock. The Series B Preferred stock is convertible into shares of common stock on a one-for-one basis. The Series B Preferred Stock has a liquidation preference of $1.30 per share plus all declared but unpaid dividends. The holders of Series B Preferred Stock are entitled to non-cumulative dividends at the rate of $0.05 per annum per share, payable when, and if declared by the Board of Directors. To date, no dividends have been declared by the Board of Directors. Holders of Series B Preferred Stock have no voting rights, except those rights provided under Delaware law. The undesignated shares of preferred stock will have rights, preferences, privileges and restrictions, including voting rights, dividend rights, conversion rights, redemption privileges and liquidation preferences, as shall be determined by the Board of Directors upon issuance of the preferred stock. The Company has reserved 3,562,238 shares of its common stock for issuance upon conversion of the Series B Preferred Stock.

Common Stock

On May 5, 2005, the Company entered into a Securities Purchase Agreement (the Securities Purchase Agreement) by and among the Company, Warburg Pincus Private Equity VIII, L.P. and certain of its affiliated entities (collectively Warburg Pincus) pursuant to which Warburg Pincus agreed to purchase, and the Company agreed to sell, 3,537,736 shares of its common stock and warrants to purchase 863,236 shares of its common stock for an aggregate purchase price of $15.1 million. The warrants have an exercise price of $5.00 per share and a term of four years. On May 9, 2005, the sale of the shares and the warrants pursuant to the Securities Purchase Agreement was completed. The Company also entered into a Stock Purchase Agreement (the Stock Purchase Agreement) by and among the Company and Warburg Pincus pursuant to which Warburg Pincus agreed to purchase and the Company agreed to sell 14,150,943 shares of the Company s common stock and warrants to purchase 3,177,570 shares of the Company s common stock for an aggregate purchase price of $60.0 million. The warrants have an exercise price of $5.00 per share and a term of four years. On September 15, 2005, the sale of the shares and the warrants pursuant to the Securities Purchase Agreement was completed. The net proceeds from these two fiscal 2005 financings was $73.9 million. In connection with the financings, the Company granted Warburg Pincus registration rights giving Warburg Pincus the right to request that the Company use commercially reasonable efforts to register some or all of the shares of common stock issued to Warburg Pincus under both the Securities Purchase Agreement and Stock Purchase Agreement, including shares of common stock underlying the warrants. The Company has evaluated these warrants under EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock and has determined that the warrants should be classified within the stockholders equity section of the accompanying consolidated balance sheet.

The Company has issued shares of its common stock in connection with several of its acquisitions. See Note 3 and Note 14 for further disclosure relating to these issuances.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Common Stock Repurchases

As of September 30, 2006 and 2005 the Company had repurchased a total of 3,030,183 and 2,846,861 shares, respectively, under various repurchase programs, discussed below. The Company intends to use the repurchased shares for its employee stock plans and for potential future acquisitions. During fiscal 2006 and 2005, the Company repurchased 183,322 and 75,354 shares of common stock at a cost of $1.4 million and $0.4 million, respectively, to cover employees tax obligations related to vesting of restricted stock.

Common Stock Warrants

In fiscal 2005 the Company issued several warrants for the purchase of its common stock. Warrants were issued to Warburg Pincus as described above. Additionally, on November 15, 2004, in connection with the acquisition of Phonetic (Note 3), the Company issued unvested warrants to purchase 750,000 shares of its common stock at an exercise price of $4.46 per share that will vest, if at all, upon the achievement of certain performance targets. The initial valuation of the warrants occurred upon closing of the Phonetic acquisition, February 1, 2005, and was treated as purchase consideration in accordance with EITF 97-8, Accounting for Contingent Consideration Issued in a Purchase Business Combination.

In March 1999 the Company issued Xerox a ten-year warrant with an exercise price for each warrant share of $0.61. This warrant is exercisable for the purchase of 525,732 shares of the Company s common stock. On March 19, 2004, the Company announced that Warburg Pincus, a global private equity firm, had agreed to purchase all outstanding shares of the Company s stock held by Xerox Corporation, including this warrant, for approximately $80 million. In connection with this transaction, Warburg Pincus acquired new warrants to purchase 2.5 million additional shares of the Company s common stock from the Company for total consideration of $0.6 million. The warrants have a six-year life and an exercise price of $4.94. The Company received this payment of $0.6 million during the quarter ended June 30, 2004.

In connection with the March 31, 2003 acquisition of the certain intellectual property assets (Note 8), the Company issued a warrant for the purchase of 78,000 shares of the Company s common stock at an exercise price of $8.10 per share. The warrant was immediately exercisable and was valued at $0.1 million based upon the Black-Scholes option pricing model with the following assumptions: expected volatility of 80%, a risk-free rate of 1.87%, an expected term of 2.5 years, no dividends and a stock price of $4.57 based on the Company s stock price at the time of issuance. This warrant expired unexercised on October 31, 2005.

In connection with the acquisition of SpeechWorks in 2003, the Company issued a warrant to its investment banker, expiring on August 11, 2009, for the purchase of 150,000 shares of the Company s common stock at an exercise price of $3.98 per share. The warrant became exercisable August 11, 2005, and was valued at its issuance at $0.2 million based upon the Black-Scholes option pricing model with the following assumptions: expected volatility of 60%, a risk-free interest rate of 4.03%, an expected term of 8 years, no dividends and a stock price of $3.92, based on the Company s stock price at the time of issuance.

Also in connection with the acquisition of SpeechWorks, the Company assumed outstanding warrants previously issued by SpeechWorks to America Online. These warrants allow for the purchase of up to 219,421 shares of the Company s common stock, and were issued in connection with a long-term marketing arrangement. The warrant is currently exercisable at a price of $14.49 per share and expires on June 30, 2007. The value of the warrant was insignificant.

Based on its review of EITF 00-19, the Company has determined that each of the above-noted warrants should be classified within the stockholders equity section of the accompanying consolidated balance sheet.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

16. Share-Based Payment

The Company adopted SFAS No. 123 (revised 2004), Share-Based Payment, (SFAS 123R) effective October 1, 2005. The Company has several equity instruments that are required to be evaluated under SFAS 123R, including: stock option plans, an employee stock purchase plan, awards in the form of restricted shares (Restricted Stock) and awards in the form of units of stock purchase rights (Restricted Units). The Restricted Stock and Restricted Units are collectively referred to as Restricted Awards. SFAS 123R requires the recognition of the fair value of share-based payments as a charge against earnings. The Company recognizes share-based payment expense over the requisite service period of the individual grantees, which generally equals the vesting period. Based on the provisions of SFAS 123R the Company s share-based payments awards are accounted for as equity instruments. Prior to October 1, 2005, the Company followed APB 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for share-based payment. The Company has elected the modified prospective transition method for adopting SFAS 123R. Under this method, the provisions of SFAS 123R apply to all awards granted or modified after the date of adoption, as well as to the future vesting of awards granted and not vested as of the date of adoption. The amounts included in the consolidated statements of operations relating to share-based payments are as follows (dollars in thousands):

	2006	2005	2004
Cost of product and licensing	$ 88	$ 10	$
Cost of professional services, subscription and hosting	1,873	107	59
Cost of maintenance and support	525	15	7
Research and development	4,578	241	228
Selling and marketing	7,332	872	420
General and administrative	7,471	1,751	587
Restructuring and other charges, net			231
Cumulative effect of accounting change	672		
	$ 22,539	$ 2,996	$ 1,532

The Company s deferred stock-based compensation balance of $8.8 million as of September 30, 2005, which was accounted for under APB 25, was reclassified against additional paid-in-capital upon the adoption of SFAS 123R. The deferred stock-based compensation balance was composed of $4.8 million from the issuance of Restricted Awards and $4.0 million relating to the intrinsic value of stock options assumed in the Company s September 2005 acquisition of Former Nuance. The unrecognized expense of awards not yet vested at October 1, 2005 is being recognized in net income (loss) in the periods after that date, based on their fair value which was determined using the Black-Scholes valuation method, and the assumptions determined under the original provisions of SFAS 123, Accounting for Stock-Based Compensation.

In connection with the adoption of SFAS 123R, the Company is required to amortize stock-based instruments with performance-related vesting terms over the period from the grant date to the sooner of the date upon which the performance vesting condition will be met (when that condition is expected to be met), or the time-based vesting dates. The cumulative effect of the change in accounting principle from APB 25 to SFAS 123R relating to this change was $0.7 million, and is included in the accompanying consolidated statement of operations for fiscal 2006.

Stock Options

The Company has several share-based compensation plans under which employees, officers, directors and consultants may be granted stock options to purchase the Company s common stock generally at the fair market value on the date of grant. Plans do not allow for options to be granted at below fair market value nor

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

can they be re-priced at anytime. Options granted under original plans of the Company become exercisable over various periods, typically two to four years and have a maximum term of 7 years. The Company also assumed an option plan in connection with its acquisition of Former Nuance on September 15, 2005. These stock options are governed by the original agreement (the Former Nuance Stock Option Plan) that they were issued under, but are now exercisable for shares of the Company. No further stock options may be issued under the Former Nuance Stock Option Plan. At September 30, 2006, 28,535,613 shares were authorized for grant under the Company s stock option plans, of which 5,131,476 shares were available for future grant. All stock options have been granted with exercise prices equal to or greater than the fair market value of the Company s common stock on the date of grant. Stock options outstanding were as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value(1)
Outstanding at December 31, 2003	17,845,632	$ 3.82		
Granted	3,489,750	$ 4.89		
Exercised	(2,238,588)	$ 2.22		
Forfeited	(2,301,856)	$ 4.70		
Outstanding at September 30, 2004	16,794,938	$ 4.14		
Assumed in acquisition of Former Nuance	9,379,433	$ 3.87		
Granted	4,534,050	$ 4.30		
Exercised	(1,655,074)	$ 2.94		
Forfeited	(1,938,498)	$ 4.74		
Outstanding at September 30, 2005	27,114,849	$ 4.10		
Granted	3,417,064	$ 8.59		
Exercised	(7,582,650)	$ 3.79		
Forfeited	(1,138,454)	$ 4.53		
Expired	(1,156,726)	$ 6.54		
Outstanding at September 30, 2006	20,654,083	$ 4.80	5.6 years	$ 72.4 million
Exercisable at September 30, 2006	13,026,514	$ 4.00	5.3 years	$ 54.3 million

(1) The aggregate intrinsic value on this table was calculated based on the positive difference between the closing market value of the Company s common stock on September 30, 2006 ($8.17) and the exercise price of the underlying options.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes information about stock options outstanding under all stock option plans at September 30, 2006:

	Options Outstanding				Options Exercisable			
Exercise Price Range	Number of Shares	Weighted Average Remaining Life in Years		Weighted Average Exercise Price	Number of Shares		Weighted Average Exercise Price
$0.16 $1.35	2,314,894	4.18	$	1.29	2,314,415	$	1.29
$1.41 $3.45	2,426,512	6.52	$	2.41	1,959,801	$	2.34
$3.46 $3.88	2,305,710	5.62	$	3.81	1,067,542	$	3.79
$3.92 $4.29	2,402,242	5.32	$	4.12	1,665,646	$	4.11
$4.30 $4.84	2,384,340	5.62	$	4.53	1,694,883	$	4.51
$4.86 $5.36	2,614,464	5.86	$	5.25	1,522,898	$	5.29
$5.38 $6.97	2,887,310	5.06	$	6.27	2,561,859	$	6.31
$7.03 $9.30	2,626,047	6.56	$	8.15	226,220	$	7.49
$10.06 $11.81	687,564	6.59	$	11.02	13,250	$	10.14
$12.41 $12.41	5,000	6.58	$	12.41			
$0.16 $12.41	20,654,083	5.63	$	4.80	13,026,514	$	4.00

Stock options to purchase 13,026,514, 17,709,565 and 10,018,921 shares of common stock were exercisable as of September 30, 2006, 2005 and 2004, respectively.

As of September 30, 2006, the total unamortized fair value of stock options was $24.7 million with a weighted average remaining recognition period of 2.3 years. During fiscal years 2006, 2005, and 2004 the following activity occurred under the Company s plans:

	2006		2005		2004	
Weighted-average grant-date fair value per share	$	4.52	$	1.87	$	2.78
Total intrinsic value of stock options exercised	$	36.7 million	$	3.3 million	$	11.7 million

The fair value of the stock options granted in fiscal 2006 was estimated on the dates of grant using the Black-Scholes model with the following weighted-average assumptions:

Dividend yield	0.0%
Expected volatility	60.9%

Average risk-free interest rate	4.8%
Expected term (in years)	4.3

The dividend yield of zero is based on the fact that the Company has never paid cash dividends and has no present intention to pay cash dividends. Expected volatility is based on the historical volatility of the Company s common stock over the period commensurate with the expected life of the options and the historical implied volatility from traded options with a term of 180 days or greater. The risk-free interest rate is derived from the average U.S. Treasury STRIPS rate during the period, which approximates the rate in effect at the time of grant, commensurate with the expected life of the instrument. Upon the adoption of SFAS 123R, the Company used the simplified method provided for under SEC Staff Accounting Bulletin No. 107, which averages the contractual term of the Company s options (7.0 years) with the vesting term (2.2 years). Beginning in the fourth quarter of 2006 the Company estimated the expected life based on the historical exercise behavior.

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Restricted Awards

The Company is authorized to issue equity incentive awards in the form of Restricted Awards. Unvested Restricted Awards may not be sold, transferred or assigned. The fair value of the Restricted Awards is measured based upon the market price of the underlying common stock as of the date of grant, reduced by the purchase price of $0.001 per share of the awards. The Restricted Awards generally are subject to vesting of a period of two to four years, and may have opportunities for acceleration for achievement of defined goals. Beginning in fiscal 2006, the Company began to issue certain Restricted Awards with vesting solely dependent on the achievement of specified performance targets. The fair value of the Restricted Awards is amortized to expense over its applicable vesting period using the straight-line method. In the event that the employees employment with the Company terminates, or in the case of awards with only performance goals those goals are not met, any unvested share shall be forfeited and revert to the Company.

Restricted Units are not included in issued and outstanding common stock until the shares are vested, at which point they are included as issued and outstanding. The table below summarizes activity relating to Restricted Units during fiscal 2006:

	Number of Shares Underlying Restricted Units	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value(1)
Outstanding at December 31, 2003			
Granted	391,283		
Vested			
Forfeited	(4,274)		
Outstanding at September 30, 2004	387,009		
Granted	580,643		
Vested	(101,543)		
Forfeited	(16,658)		
Outstanding at September 30, 2005	849,451		
Granted	2,473,223		
Vested	(471,462)		
Forfeited	(101,158)		
Outstanding at September 30, 2006	2,750,054	1.6 years	$ 22.5 million
Expected to become exercisable	2,478,679	1.6 years	$ 20.2 million

(1) The aggregate intrinsic value on this table was calculated based on the positive difference between the closing market value of the Company s common stock on September 30, 2006 ($8.17) and the exercise price of the underlying Restricted Units.

The purchase price for vested Restricted Units is $0.001 per share. As of September 30, 2006, unearned share-based payments expense related to unvested Restricted Units is $16.1 million, which will, based on expectations of future performance vesting criteria, where applicable, be recognized over a weighted-average period of 1.4 years. 43.7% of the Restricted Units outstanding as of September 30, 2006 are subject to

NUANCE COMMUNICATIONS, INC.

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performance vesting acceleration conditions. During fiscal years 2006, 2005, and 2004 the following activity occurred related to Restricted Units:

	2006	2005	2004
Weighted-average grant-date fair value per share	$ 9.15	$ 4.67	$ 4.52
Total intrinsic value of shares vested	$ 4.0 million	$ 0.5 million	$

Restricted Stock is included in the issued and outstanding common stock in these financial statements at date of grant. The table below summarizes activity relating to Restricted Stock during fiscal 2006:

	Number of Shares Underlying Restricted Stock	Weighted Average Grant Date Fair Value
Nonvested balance at December 31, 2003	579,458	
Granted	752,893	
Vested	(187,404)	
Forfeited	(46,389)	
Nonvested balance at September 30, 2004	1,098,558	
Granted	446,663	
Vested	(215,947)	
Forfeited	(203,571)	
Nonvested balance at September 30, 2005	1,125,703	$ 4.60
Granted	745,145	$ 7.63
Vested	(311,671)	$ 5.22
Forfeited	(11,836)	$ 3.89
Nonvested balance at September 30, 2006	1,547,341	$ 5.93

The purchase price for vested Restricted Stock is $0.001 per share. As of September 30, 2006, unearned share-based payments expense related to unvested Restricted Stock is $6.2 million, which will, based on expectations of future performance vesting criteria, when applicable, be recognized over a weighted-average period of 1.5 years. 85.6% of the Restricted Stock outstanding as of September 30, 2006 are subject to performance vesting acceleration conditions. During fiscal years 2006, 2005, and 2004 the following activity occurred related to Restricted Stock:

	2006	2005	2004

Weighted-average grant-date fair value per share	$ 7.63	$ 3.79	$ 5.56
Total fair value of shares vested	$ 2.2 million	$ 1.0 million	$ 1.0 million

The Company has historically repurchased common stock upon its employees vesting in Restricted Awards, in order to allow the employees to cover their tax liability as a result of the Restricted Awards having vested. Assuming that the Company repurchased one-third of all vesting Restricted Awards outstanding as of September 30, 2006, such amount approximating a tax rate of its employees, and based on the weighted average recognition period of 1.4 years, the Company would repurchase approximately 2.0 million shares during the twelve month period ending September 30, 2007. During fiscal 2006, the Company repurchased 183,322 shares of common stock at a cost of $1.4 million to cover employees tax obligations related to vesting of Restricted Awards.

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1995 Employee Stock Purchase Plan

The Company s 1995 Employee Stock Purchase Plan (the Plan), as amended and restated on May 14, 2005, authorizes the issuance of a maximum of 3,000,000 shares of common stock in semi-annual offerings to employees at a price equal to the lower of 85% of the closing price on the applicable offering commencement date or 85% of the closing price on the applicable offering termination date. Compensation expense for the employee stock purchase plan is recognized in accordance with SFAS 123R. At September 30, 2006, 1,010,830 million shares were reserved for future issuance. During fiscal 2006, 2005, and 2004, The Company issued 419,561, 385,265 and 332,119 shares of common stock under this plan, respectively. The weighted average fair value of all purchase rights granted in fiscal 2006, 2005 and 2004, were $2.62, $1.29 and $1.51.

The fair value of the purchase rights granted under this plan was estimated on the date of grant using the Black-Scholes option-pricing model that uses the following weighted-average assumptions which were derived in a manner similar to those discussed above relative to stock options:

	2006	2005	2004
Dividend yield	0.0%	0.0%	0.0%
Expected volatility	55.1%	52.3%	50.0%
Average risk-free interest rate	5.0%	3.2%	1.5%
Expected term (in years)	0.5	0.4	0.5

17. Commitments and Contingencies

Operating Leases

The Company has various operating leases for office space around the world. In connection with many of its acquisitions the Company assumed facility lease obligations. Among these assumed obligations are lease payments related to certain office locations that were vacated by certain of the acquired companies prior to the acquisition date (Note 12). Additionally, certain of the Company s lease obligations have been included in various restructuring charges (Note 13). The following table outlines the Company s gross future minimum payments under all non-cancelable operating leases as of September 30, 2006 (in thousands):

Year Ending September 30,	Operating Leases	Leases Under Restructuring	Other Contractual Obligations Assumed	Total
2007	$ 6,028	$ 2,035	$ 12,371	$ 20,434
2008	7,020	1,560	12,780	21,360
2009	6,720	1,431	13,202	21,353
2010	5,627	543	13,639	19,809

2011	4,842	560	14,172	19,574
Thereafter	19,425	922	22,754	43,101
Total	$ 49,662	$ 7,051	$ 88,918	$ 145,631

At September 30, 2006, the Company has subleased certain office space to third parties. Total sub-lease income under contractual terms is $21.9 million, which ranges from $1.7 million to $3.0 million on an annual basis through February 2016.

Total rent expense charged to operations was approximately $7.2 million, $7.4 million and $4.0 million for the years ended September 30, 2006, 2005 and 2004, respectively.

In connection with certain of its acquisitions, the Company assumed certain financial guarantees that the acquired companies had committed to the landlords of certain facilities. These financial guarantees are secured by the 2006 Credit Facility or are secured by certificates of deposit. The total financial guarantees were

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$17.8 million, of which $0.8 and $11.7 million were secured by certificates of deposit which were classified as restricted cash in other assets as of September 30, 2006 and 2005, respectively.

Litigation and Other Claims

Like many companies in the software industry, the Company has, from time to time been notified of claims that it 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, the Company 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 the Company 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 the Company.

On November 9, 2006, VoiceSignal Technologies, Inc. filed an action against the Company and eleven of its resellers in the United States District Court for the Eastern District of Texas claiming patent infringement. VoiceSignal is seeking damages and injunctive relief. In the lawsuit, VoiceSignal alleges that the Company is infringing United States Patent No. 5,855,000 which is related to improving correction in a dictation application based on a two input analysis. The Company believes the claims have no merit, and intends to defend the action vigorously.

On August 22, 2006, z4 Technologies, Inc. filed an action against the Company and five other defendants, including Symantec, Adobe, Quark, ABBYY and Mathsoft, in the United States District Court for the Eastern District of Texas claiming patent infringement. Damages were sought in an unspecified amount. In the lawsuit, z4 Technologies alleges that the Company is infringing United States Patent Nos. 6,044,471 and 6,785,825 which are directed to a method and apparatus for reducing unauthorized software use. On December 4, 2006, the Company entered into a settlement agreement with z4 Technologies regarding this action. (See Note 23.)

On May 31, 2006 GTX Corporation (GTX), filed an action against the Company in the United States District Court for the Eastern District of Texas claiming patent infringement. Damages were sought in an unspecified amount. In the lawsuit, GTX alleged that the Company was infringing United States Patent No. 7,016,536 entitled Method and Apparatus for Automatic Cleaning and Enhancing of Scanned Documents. The Company believes the claims have no merit, and it intends to defend the action vigorously.

On November 27, 2002, AllVoice Computing plc (AllVoice) filed an action against the Company in the United States District Court for the Southern District of Texas claiming patent infringement. In the lawsuit, AllVoice alleges that the Company is infringing United States Patent No. 5,799,273 entitled Automated Proofreading Using Interface Linking Recognized Words to Their Audio Data While Text Is Being Changed (the 273 Patent). The 273 Patent generally discloses techniques for manipulating audio data associated with text generated by a speech recognition engine. Although the Company has several products in the speech recognition technology field, the Company believes that its products do not infringe the 273 Patent because, in addition to other defenses, they do not use the claimed techniques. Damages are sought in an unspecified amount. The Company filed an Answer on December 23, 2002. On January 4, 2005, the case was transferred to a new judge of the United States District Court for the Southern District of Texas for administrative reasons. The United States District Court for the Southern District of Texas entered summary judgment against AllVoice and dismissed all claims against Nuance on February 21, 2006. AllVoice filed a notice of appeal from the judgment on April 26, 2006.

In August 2001, the first of a number of complaints was filed in the United States District Court for the Southern District of New York, on behalf of a purported class of persons who purchased Former Nuance stock between April 12, 2000 and December 6, 2000. Those complaints have been consolidated into one action. The complaint generally alleges that various investment bank underwriters engaged in improper and undisclosed activities related to the allocation of shares in Former Nuance s initial public offering of securities. The

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

complaint makes claims for violation of several provisions of the federal securities laws against those underwriters, and also against Former Nuance and some of the Former Nuance s directors and officers. Similar lawsuits, concerning more than 250 other companies initial public offerings, were filed in 2001. In February 2003, the Court denied a motion to dismiss with respect to the claims against Former Nuance. In the third quarter of 2003, a proposed settlement in principle was reached among the plaintiffs, issuer defendants (including Former Nuance) and the issuers insurance carriers. The settlement calls for the dismissal and release of claims against the issuer defendants, including Former Nuance, in exchange for a contingent payment to be paid, if necessary, by the issuer defendants insurance carriers and an assignment of certain claims. The timing of the conclusion of the settlement remains unclear, and the settlement is subject to a number of conditions, including approval of the Court. The settlement is not expected to have any material impact upon Former Nuance or the Company, as payments, if any, are expected to be made by insurance carriers, rather than by Former Nuance. In July 2004, the underwriters filed a motion opposing approval by the court of the settlement among the plaintiffs, issuers and insurers. In March 2005, the court granted preliminary approval of the settlement, subject to the parties agreeing to modify the term of the settlement which limits each underwriter from seeking contribution against its issuer for damages it may be forced to pay in the action. On April 24, 2006, the court held a fairness hearing in connection with the motion for final approval of the settlement. The court has yet to issue a ruling on the motion for final approval. On December 5, 2006, the Court of Appeals for the Second Circuit reversed the Court s order certifying a class in several test cases that had been selected by the underwriter defendants and plaintiffs in the coordinated proceeding. The settlement remains subject to a number of conditions, including final court approval. In the event the settlement is not concluded, the Company intends to defend the litigation vigorously. The Company believes it has meritorious defenses to the claims against Former Nuance.

The Company believes that the final outcome of the current litigation matters described above will not have a significant adverse effect on its consolidated financial statements. However, even if the Company s defense is successful, the litigation could require significant management time and will be costly. Should the Company not prevail in these litigation matters, its operating results, financial position and cash flows could be adversely impacted.

Guarantees and Other

The Company currently includes indemnification provisions in the contracts into which it enters with its customers and business partners. Generally, these provisions require the Company to defend claims arising out of its products infringement of third-party intellectual property rights, breach of contractual obligations and/or unlawful or otherwise culpable conduct on its part. The indemnity obligations imposed by these provisions generally cover damages, costs and attorneys fees arising out of such claims. In most, but not all, cases, the Company s total liability under such provisions is limited to either the value of the contract or a specified, agreed upon amount. In some cases its total liability under such provisions is unlimited. In many, but not all, cases, the term of the indemnity provision is perpetual. While the maximum potential amount of future payments the Company could be required to make under all the indemnification provisions in its contracts with customers and business partners is unlimited, it believes that the estimated fair value of these provisions is minimal due to the low frequency with which these provisions have been triggered.

The Company has entered into agreements to indemnify its directors and officers to the fullest extent authorized or permitted under applicable law. These agreements, among other things, provide for the indemnification of its directors and officers for expenses, judgments, fines, penalties and settlement amounts incurred by any such person in his or her capacity as a director or officer of the Company, whether or not such person is acting or serving in any such capacity at the time any liability or expense is incurred for which indemnification can be provided under the agreements. In accordance with the terms of the SpeechWorks merger agreement, the Company is required to indemnify the former members of the SpeechWorks board of directors, on similar terms as described above, for a period of six years from the acquisition date. In

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

connection with this indemnification, the Company was required to purchase a director and officer insurance policy related to this obligation for a period of three years from the date of acquisition, this three-year policy was purchased in 2003. In accordance with the terms of each of the Former Nuance and Dictaphone merger agreements, the Company is required to indemnify the former members of the Former Nuance and Dictaphone boards of directors, on similar terms as described above, for a period of six years from the acquisition date. In connection with these indemnifications, the Company has purchased director and officer insurance policies related to these obligations covering the full period of six years.

At September 30, 2006, the Company has $7.5 million non-cancelable purchase commitments for inventory to fulfill customers orders currently scheduled in its backlog.

18. Pension and Other Post-Retirement Benefits

Defined Contribution Plan

The Company has established a retirement savings plan under Section 401(k) of the Internal Revenue Code (the 401(k) Plan). The 401(k) Plan covers substantially all employees of the Company who meet minimum age and service requirements, and allows participants to defer a portion of their annual compensation on a pre-tax basis. Effective July 1, 2003, Company match of employee s contributions was established, dollar for dollar up to 2% of salary. Employees who were hired prior to April 1, 2004 are 100% vested into the plan as soon as they start to contribute to the plan. Employees hired April 1, 2004 and thereafter, vest one-third of the contribution annually over a three-year period. The Company s contributions to the 401(k) Plan totaled $1.1 million, $0.7 million and $0.5 million for fiscal 2006, 2005 and 2004, respectively.

Defined Benefit Pension Plans and Other Post-Retirement Benefit Plan

In connection with the acquisition of Dictaphone on March 31, 2006, the Company assumed the assets and obligations related to its defined benefit pension plans, which provide certain retirement and death benefits for former Dictaphone employees located in the United Kingdom and Canada. These two pension plans were frozen prior to March 31, 2006. The Company also assumed a post-retirement health care and life insurance benefit plan, which is frozen relative to new enrollment, and which provides certain post-retirement health care and life insurance benefits, as well as a fixed subsidy for qualified former employees in the United States and Canada.

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table shows the changes in fiscal 2006 in the projected benefit obligation, plan assets and funded status of the defined benefit pension plans and the other post-retirement benefit plan. The measurement date for benefit obligations was March 31, 2006 and the measurement date for the plan assets was September 30, 2006 (in thousands).

	Pension Benefits	Other Benefits
Change in Benefit Obligation:		
Projected benefit obligation, September 30, 2005	$	$
Benefit obligation assumed in connection with the acquisition of Dictaphone	22,537	1,309
Service cost	148	50
Interest cost	589	35
Plan participants contributions	18	
Actuarial loss (gain)	(85)	6
Expenses paid	(91)	
Currency exchange rate changes	1,633	
Benefits paid	(592)	(26)
Projected benefit obligation, September 30, 2006	$ 24,157	$ 1,374
Change in Plan Assets:		
Fair value of plan assets, September 30, 2005	$	$
Plan assets acquired in connection with the acquisition of Dictaphone	17,397	
Actual return on plan assets	252	
Employer contributions	544	26
Plan participants contributions	18	
Expenses paid	(91)	
Currency exchange rate changes	1,185	
Benefits paid	(592)	(26)
Fair value of plan assets, September 30, 2006	$ 18,713	$
Funded Status:		
Funded status at September 30, 2006	$ (5,444)	$ (1,374)
Unrecognized actuarial gain (loss)	270	6
Net amount recognized	$ (5,174)	$ (1,368)
Amounts recognized in the Consolidated Balance Sheet as of September 30, 2006 consist of:		
Prepaid benefit cost	$ 2,276	$
Accrued benefit liability	(7,450)	(1,368)

Net amount recognized	$ (5,174)	$ (1,368)

The accumulated benefit obligations for the two defined benefit pension plans was $24.0 million at September 30, 2006.

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Included in the table below are the amounts relating to the Company s UK pension plan which has an accumulated benefit obligations and projected benefit obligations in excess of plan assets (in thousands):

	Pension Benefits	Other Benefits
Aggregate projected benefit obligations	$ 21,022	$ 1,374
Aggregate accumulated benefit obligations	20,848	
Aggregate fair value of plan assets	13,458	

The components of net periodic benefit cost of the benefit plans were as follows (in thousands):

	Pension Benefits	Other Benefits
Service cost	$ 148	$ 50
Interest cost	589	35
Expected return on plan assets	(605)	
Net periodic pension cost	$ 132	$ 85

Plan Assumptions:

Weighted-average assumptions used in developing the benefit obligations and net periodic benefit cost for the plans were as follows:

	Pension Benefits	Other Benefits
Discount rate	5.0%	5.5%
Average compensation increase	4.0%	NA(1)
Expected rate of return on plan assets	6.7%	NA(2)

(1) Rate of compensation increase is not applicable to the Company s other benefits as compensation levels do not impact earned benefits.

(2) Expected return on plan assets is not applicable to the Company s other benefit plan as the plan is unfunded.

Because the benefit provided to retirees under the other postretirement benefit plan consists of a fixed subsidy, no health care cost trend is assumed in the measurement of the post-retirement benefit obligations and net periodic benefit costs for fiscal 2006.

The Company considered several factors when developing the expected return on plan assets including the analysis of return relevant to the country where each plan is in effect as well as the historical rates of return from investment. In addition, the Company reviews local actuarial projections and market outlook from investment managers. The expected rate of return above is weighted to reflect each country s relative portion of the plan assets.

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Assets Allocation and Investment Strategy:

The percentages of the fair value of plan assets actually allocated and targeted for allocation, by asset category, at September 30, 2006, were as follows:

Asset Category	Actual	Target
Equity securities	63.1%	57.0%
Debt securities	36.9%	43.0%
Total	100.0%	100.0%

The Company s investment goal for pension plan assets is designed to provides as much assurance as is possible, in the Company s opinion, that the pension assets are available to pay benefits as they come due and minimize market risk. The expected long-term rate of return for the plan assets is 6.3% for the UK pension plan and 7.5% for the Canadian pension plan.

Employer Contributions:

The Company expects to contribute $1.7 million to its pension plans in fiscal 2007. Included in this contribution is a minimum funding requirement associated with its UK pension which requires annual minimum payment of £859,900 (approximately $1.6 million based on exchange rate at September 30, 2006) for each of the next 5 years until fiscal 2011. Its other post-retirement benefits plan is a non-funded plan, and cash contributions are made each year to cover claims costs incurred in that year. Total cash paid during fiscal 2006 for the post-retirement health care and life insurance benefit plan was not material, and the Company does not expect that the amount in fiscal 2007 will be material.

Estimated Future Benefit Payments:

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid (in thousands):

Fiscal Year	Pension Benefits	Other Benefits
2007	$ 1,192	49
2008	1,216	50
2009	1,239	50
2010	1,263	57
2011	1,288	65
2012-2016	6,592	428

Total	$ 12,790	$ 699

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

19. Income Taxes

The components of the income tax provision (benefit) are as follows (in thousands):

	Year Ended September 30, 2006	Year Ended September 30, 2005	Nine Months Ended September 30, 2004
Current			
Federal	$ 334	$ 269	$
Foreign	1,579	(33)	451
State	4,420	1,526	23
	6,333	1,762	474
Deferred			
Federal	$ 7,638	$ 4,682	$ 705
Foreign	1,002	(342)	24
State	171	710	130
	8,811	5,050	859
Provision for income taxes	$ 15,144	$ 6,812	$ 1,333

For financial reporting purposes, income (loss) before income taxes includes the following components (in thousands):

	Year Ended September 30, 2006	Year Ended September 30, 2005	Nine Months Ended September 30, 2004
Domestic income (loss)	$ (16,318)	$ 5,586	$ (10,413)
Foreign income (loss)	9,247	(4,191)	2,368
Income (losses) before income taxes	$ (7,071)	$ 1,395	$ (8,045)

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Deferred tax assets (liabilities) consist of the following (in thousands):

	September 30, 2006	September 30, 2005
Deferred tax assets:		
Net operating loss carryforwards	$ 247,337	$ 167,771
Federal and state credit carryforwards	24,685	15,865
Capitalized start-up and development costs	8,069	6,405
Accrued expenses and other reserves	34,505	44,679
Deferred revenue	53,454	4,343
Deferred compensation	4,418	1,131
Depreciation	1,547	3,068
Other	1,050	267
Total deferred tax assets	375,065	243,529
Valuation allowance for deferred tax assets	(329,722)	(214,834)
Net deferred tax assets	45,343	28,695
Deferred tax liabilities:		
Acquired intangibles	(64,848)	(32,936)
Net deferred tax liabilities	$ (19,505)	$ (4,241)
Reported as:		
Current deferred tax assets	$ 421	$
Long-term deferred tax liabilities	(19,926)	(4,241)
Net deferred tax liabilities	$ (19,505)	$ (4,241)

At September 30, 2006 and 2005, the Company had federal net operating loss carryforwards of approximately $602.0 million and $379.0 million, respectively, of which approximately $24.6 million and $29.0 million, respectively, relate to tax deductions from share-based payments. At September 30, 2006 and 2005, the Company had state net operating loss carryforwards of approximately $84.7 million and $93.0 million, respectively. At September 30, 2006, the Company had federal and state research and development carryforwards of approximately $16.3 million and $9.6 million, respectively. At September 30, 2005, the Company had federal and state research and development credit carryforwards of approximately $9.6 million and $6.5 million, respectively. The net operating loss and credit carryforwards will expire at various dates beginning in 2009 and extending through 2025, if not utilized.

Utilization of the net operating losses and credits are subject to an annual limitation due to the ownership change limitations provided by the Internal Revenue Code of 1986 and similar state tax provisions. The annual limitation will result in the expiration of certain net operating losses and credits before utilization.

Significant management judgment is required in determining our provision for income taxes and in determining whether deferred tax assets will be realized in full or in part. When it is more likely than not that all or some portion of specific deferred tax assets such as net operating losses or foreign tax credit carryforwards will not be realized, a valuation allowance must be established for the amount of the deferred tax assets that are determined not likely to be realizable. Realization is based upon a number of factors, including our ability to generate sufficient future taxable income. The valuation allowance was determined in accordance with the provisions of SFAS 109, Accounting for Income Taxes, which requires an assessment of both positive and negative evidence when determining whether it is more likely than not that deferred tax assets are recoverable. Such assessment is required on a jurisdiction-by-jurisdiction basis. The Company does

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

not expect to reduce its valuation allowance significantly until sufficient positive evidence exists, including sustained profitability, that its deferred tax assets are more likely than not to be realized. The Company will maintain a full valuation allowance on its net U.S. deferred tax assets until sufficient positive evidence exists to support reversal of the valuation allowance.

As of September 30, 2006, the company s valuation allowance for U.S. net deferred tax assets totaled $312.1 million, which consists of the beginning of the year allowance of $193.3 million and 2006 charges (benefits) of $10.1 million to income from operations and $0.7 million to other comprehensive income. A portion of the deferred tax liabilities are created by goodwill, and are not allowed as an offset to deferred tax assets for purposes of determining the amount of valuation allowance required. Following the adoption of SFAS 142, deferred tax liabilities resulting from the different treatment of goodwill for book and tax purposes cannot offset deferred tax assets in determining the valuation allowance. As a result, a deferred tax provision is required to increase the Company s valuation allowance.

The valuation allowance reduces the carrying value of the deferred tax assets generated by foreign tax credits, reserves and accruals and net operating loss (NOL) carryforwards, which would require sufficient future ordinary income in order to realize the tax benefits. If the Company generates taxable income through profitable operations in future years it may be required to recognize these deferred tax assets through the reduction of the valuation allowance which would result in a material benefit to its results of operations in the period in which the benefit is determined, excluding the recognition of the portion of the valuation allowance which relates to net deferred tax assets acquired in a business combination and share-based payments. The valuation allowance associated with tax assets arising in connection with share-based payments of $8.7 and $11.0 million as of September 30, 2006 and 2005, respectively, will be accounted for as additional paid in capital. The valuation allowance associated with tax assets arising from business combinations of $264.3 and $178.5 million as of September 30, 2006 and 2005, respectively, when released, will reduce goodwill, other intangible assets, and to the extent remaining, the provision for income taxes.

A reconciliation of the Company s effective tax rate to the statutory federal rate is as follows:

	Year Ended September 30, 2006	Year Ended September 30, 2005	Nine Months Ended September 30, 2004
Federal statutory tax rate	35.0%	35.0%	35.0%
Share-based payments	(32.1)		
Foreign taxes	(8.2)	180.6	6.0
State tax, net of federal benefit	(40.9)	66.4	7.7
Nondeductible expenditures	(6.4)		
Other	(4.1)	4.8	(2.7)
Change in valuation allowance	(159.5)	323.4	(70.1)
Federal research and development credits			7.5
Federal benefit refundable taxes		(121.9)	
Federal credits, net	2.0		

	(214.2)%	488.3%	(16.6)%

The cumulative amount of undistributed earnings of the Company s foreign subsidiaries amounted to, approximately $10.4 million at September 30, 2006. The Company has not provided any additional federal or state income taxes or foreign withholding taxes on the undistributed earnings, as such earnings have been indefinitely reinvested in the business. An estimate of the tax consequences from the repatriation of these

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NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

earnings is not practicable at this time resulting from the complexities of the utilization of foreign tax credits and other tax assets.

20. Segment and Geographic Information and Significant Customers

The Company has reviewed the provisions of SFAS 131, Disclosures about Segments of an Enterprise and Related Information, with respect to the criteria necessary to evaluate the number of operating segments that exist. Based on its review, the Company has determined that it operates in one segment. Changes in the organization or the Company s management reporting structure, as well as other events and circumstances, including but not limited to technological advances, increased competition and changing economic or market conditions, could result in (a) shorter estimated useful lives, (b) additional reporting units, which may require alternative methods of estimating fair values or greater disaggregation or aggregation in our analysis by reporting unit, and/or (c) other changes in previous assumptions or estimates. In turn, this could have a significant impact on the consolidated financial statements through accelerated amortization and/or impairment charges.

Revenue, classified by the major geographic areas in which the Company s customers are located, were as follows (in thousands):

	Year Ended September 30, 2006	Year Ended September 30, 2005	Nine Months Ended September 30, 2005
United States	$ 288,300	$ 160,927	$ 91,472
International	100,210	71,461	39,435
Total	$ 388,510	$ 232,388	$ 130,907

No country outside of the United States composed greater than 10% of total revenue.

The following table presents revenue information for principal product lines, which do not constitute separate segments (in thousands):

	Year Ended September 30, 2006	Year Ended September 30, 2005	Nine Months Ended September 30, 2005
Speech	$ 316,106	$ 164,244	$ 86,594
Imaging	72,404	68,144	44,313

Total	$	388,510	$	232,388	$	130,907

Two distribution and fulfillment partners, Ingram Micro and Digital River, each accounted for 6% of the Company s consolidated revenue for fiscal 2006, 11% and 9% for fiscal 2005 and 14% and 8% for fiscal 2004, respectively. No customer accounted for greater than 10% of accounts receivable as of September 30, 2006 or 2005.

The following table summarizes the Company s long-lived assets, including intangible assets and goodwill, by geographic location (in thousands):

		September 30, 2006		September 30, 2005
United States	$	865,884	$	515,477
International		105,869		66,833
Total	$	971,753	$	582,310

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

21. Pro Forma Results (Unaudited)

The following table reflects unaudited pro forma results of operations of the Company assuming that the Telelogue, Rhetorical, ART, Phonetic, Former Nuance and Dictaphone acquisitions had occurred on October 1, 2004 (in thousands, except per share data):

	Fiscal 2006	Fiscal 2005
Revenue	$ 470,340	$ 448,277
Net loss	$ (63,317)	$ (82,504)
Net loss per share	$ (0.39)	$ (0.55)

22. Related Parties

At December 31, 2003, Xerox owned approximately 15% of the Company s outstanding common stock and all of the Company s outstanding Series B Preferred Stock. In addition, Xerox had the opportunity to acquire additional shares of common stock pursuant to a warrant (Note 15). On March 19, 2004, the Company announced that Warburg Pincus, had agreed to purchase all outstanding shares of the Company s stock held by Xerox Corporation for approximately $80 million. As a result of the Xerox and Warburg Pincus transaction, Xerox is no longer a related party as of June 30, 2004. During fiscal 2004, Xerox s related party revenue accounted for approximately 1% of the Company s total revenue under several non-exclusive agreements in which the Company grants Xerox the royalty-bearing right to copy and distribute certain versions of the Company s software programs. The Company does not engage in transactions in the normal course of its business with Warburg Pincus.

At September 30, 2005, a member of the Company s Board of Directors was a senior executive at Convergys Corporation. In October 2005, the member of the Company s Board of Directors discontinued his affiliation with Convergys, and as a result, Convergys is no longer a related party. The Company and Convergys have entered into multiple non-exclusive agreements in which Convergys resells the Company s software. Revenue from Convergys during fiscal 2006, 2005 and 2004 were not material.

A member of the Company s Board of Directors is also a partner at Wilson Sonsini Goodrich & Rosati, Professional Corporation, a law firm that provides services to the Company. In fiscal 2006, 2005 and 2004, the Company paid $4.9 million, $2.1 million and $0.7 million, respectively, to Wilson Sonsini Goodrich & Rosati for professional services provided to the Company. As of September 30, 2006 and 2005 the Company had $0.6 million and $2.5 million, respectively, included in accounts payable and accrued expenses to Wilson Sonsini Goodrich & Rosati.

23. Subsequent Events

On December 4, 2006, the Company entered into a settlement and license agreement with z4 Technologies regarding the actions filed against the Company on August 22, 2006. In connection with this settlement the Company agreed to license various technologies from z4 Technologies, Inc. $0.4 million is included in cost of revenue from amortization of intangible assets in the accompanying fiscal 2006 statement of operations.

On December 5, 2006, the Company entered into an agreement and plan of merger to acquire Mobile Voice Control, Inc. (MVC), a provider of speech-enabled mobile search and messaging services headquartered in Mason, Ohio. The transaction is expected to close prior to December 31, 2006 and is subject to customary closing conditions. Under the terms of the plan of merger, the purchase price payable to MVC s stockholders consists of cash and 824,276 shares of the Company s common stock. Up to an additional 1,700,840 shares of common stock may also be issued, if at all, upon the achievement of certain revenue milestones for the calendar years 2007 and 2008; no portion of these contingent shares is guaranteed.

NUANCE COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

24. Quarterly Data (Unaudited)

The following information has been derived from unaudited consolidated financial statements that, in the opinion of management, include all recurring adjustments necessary for a fair statement of such information (in thousands, except per share amounts):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
2006					
Total revenue	$ 75,552	$ 71,728	$ 113,096	$ 128,134	$ 388,510
Gross margin	$ 55,415	$ 51,506	$ 76,028	$ 84,518	$ 267,467
Net loss	$ (4,892)	$ (1,380)	$ (9,400)	$ (7,215)	$ (22,887)
Net loss per share					
Basic	$ (0.03)	$ (0.01)	$ (0.06)	$ (0.04)	$ (0.14)
Diluted	$ (0.03)	$ (0.01)	$ (0.06)	$ (0.04)	$ (0.14)
Weighted average common shares outstanding:					
Basic	156,389	163,407	167,482	168,244	163,873
Diluted	156,389	163,407	167,482	168,244	163,873

The fourth quarter of fiscal 2006 included an impairment charge of $2.6 million that was recorded in order to value the purchased computer software at its net realizable value.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
2005					
Total revenue	$ 60,578	$ 53,113	$ 56,814	$ 61,883	$ 232,388
Gross margin	$ 42,606	$ 36,264	$ 40,018	$ 44,297	$ 163,185
Net income (loss)	$ 3,141	$ (1,002)	$ 160	$ (7,716)	$ (5,417)
Net income (loss) per share					
Basic	$ 0.03	$ (0.01)	$ 0.00	$ (0.06)	$ (0.05)
Diluted	$ 0.03	$ (0.01)	$ 0.00	$ (0.06)	$ (0.05)
Weighted average common shares outstanding:					
Basic	104,973	105,563	108,713	118,816	109,540
Diluted	112,430	105,563	116,413	118,816	109,540

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Voice Signal Technologies, Inc.

Quarterly Financial Statements

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

	June 30, 2007 (Unaudited)	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 9,316,219	$ 3,982,789
Short term investments		3,000,000
Accounts receivable	5,337,600	6,130,653
Prepaid expenses and other current assets	1,097,813	417,173
Deferred tax asset	4,027,000	3,624,000
Total current assets	19,778,632	17,154,615
Property and equipment, net	733,165	739,861
Other assets:		
Intangible assets, net	1,789,029	2,040,516
Other noncurrent assets	180,865	188,051
	1,969,894	2,228,567
	$ 22,481,691	$ 20,123,043
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS DEFICIT		
Current liabilities		
Accounts payable	$ 1,272,031	$ 926,403
Accrued expenses and other current liabilities	1,022,351	966,464
License obligation, current portion	1,031,497	894,043
Deferred revenue, current portion	3,850,238	5,645,714
Capital lease obligation, current portion	27,181	23,259
Total current liabilities	7,203,298	8,455,883
License obligation, net of current portion	785,698	876,675
Capital lease obligation, net of current portion		15,319
Deferred revenue, net of current portion	803,905	1,507,810
Total liabilities	8,792,901	10,855,687
Redeemable convertible preferred stock:		
Series C redeemable convertible preferred stock, $.001 par value; 6,383,294 shares authorized, issued and outstanding (at redemption value;	13,104,280	12,768,200

liquidation preference of $13,181,547)		
Series D redeemable convertible preferred stock, $.001 par value; 66,281,550 shares authorized, issued and outstanding (at redemption value; liquidation preference of $33,421,455)	20,079,306	19,473,944
Total redeemable convertible preferred stock	33,183,586	32,242,144
Stockholders deficit:		
Series A convertible preferred stock, $.001 par value; 5,600,000 shares authorized, issued and outstanding (liquidation preference of $560,000)	5,600	5,600
Series B convertible preferred stock, $.001 par value; 1,820,000 shares authorized, issued and outstanding (liquidation preference of $699,999)	1,820	1,820
Common stock, $.001 par value; 128,000,000 shares authorized; 17,363,196 and 17,228,794 shares issued and outstanding at June 30, 2007 and December 31, 2006 respectively	17,363	17,229
Additional paid-in capital	2,035,016	1,795,483
Accumulated deficit	(21,535,484)	(24,784,382)
Accumulated other comprehensive loss	(19,111)	(10,538)
Total stockholders deficit	(19,494,796)	(22,974,788)
	$ 22,481,691	$ 20,123,043

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Consolidated Statements of Income

	Three Months Ended June 30, 2007 (Unaudited)	Three Months Ended June 30, 2007 (Unaudited)	Six Months Ended June 30, 2007 (Unaudited)	Six Months Ended June 30, 2006 (Unaudited)
Revenues:				
Royalty	$ 5,450,623	$ 4,511,047	$ 11,257,524	$ 8,733,333
Professional services	783,326	886,016	1,291,083	1,828,550
License	173,316	347,032	416,442	694,841
Total revenues	6,407,265	5,744,095	12,965,049	11,256,724
Cost of revenues:				
Professional services	315,971	354,416	628,988	730,608
Cost of revenue from amortization of intangible assets	125,743	116,595	251,487	233,191
Total cost of revenues	441,714	471,011	880,475	963,799
Gross profit	5,965,551	5,273,084	12,084,574	10,292,925
Operating expenses:				
Research and development	1,705,035	1,549,519	3,421,099	3,080,954
General and administrative	1,092,653	1,399,499	2,387,735	2,533,230
Sales and marketing	1,175,762	998,133	2,422,663	2,019,441
	3,973,450	3,947,151	8,231,497	7,633,625
Income from operations	1,992,101	1,325,933	3,853,077	2,659,300
Interest income (expense), net	12,353	(17,272)	45,236	1,189
Income before income taxes	2,004,454	1,308,661	3,898,313	2,660,489
Benefit (provision) for income taxes	(46,968)	36,001	292,027	69,370
Net income	$ 1,957,486	$ 1,344,662	$ 4,190,340	$ 2,729,859

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Six Months Ended June 30, 2007 (Unaudited)	Six Months Ended June 30, 2006 (Unaudited)
Cash flows from operating activities:		
Net income	$ 4,190,340	$ 2,729,859
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation expense	208,528	143,490
Amortization expense	251,487	233,191
Stock-based compensation	209,575	88,857
Deferred income taxes	(403,000)	(142,967)
Non-cash interest expense	46,477	57,851
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	793,053	(1,273,321)
Prepaid expenses and other current assets	(680,640)	43,635
Other assets	7,186	171,740
Increase (decrease) in:		
Accounts payable	345,628	381,282
Accrued expenses and other current liabilities	55,887	32,964
Deferred revenue	(2,499,381)	(5,429,313)
Net cash provided by (used in) operating activities	2,525,140	(2,962,732)
Cash flows from investing activities:		
Net redemption of short term investment	3,000,000	3,064,257
Acquisitions of property and equipment	(205,584)	(232,370)
Net cash provided by investing activities	2,794,416	2,831,887
Cash flows from financing activities:		
Proceeds from exercising stock options	30,092	48,249
Payments on capital lease obligations	(11,397)	
Net cash provided by financing activities	18,695	48,249
Effect of change in exchange rates on cash	(4,821)	8,193
Net increase (decrease) in cash and cash equivalents	5,333,430	(74,403)
Cash and cash equivalents, beginning of year	3,982,789	296,816

Cash and cash equivalents, end of year	$	9,316,219	$	222,413
Supplemental disclosures of cash flow information:				
Cash paid during the year for:				
Interest	$	6,470	$	25,059
Income taxes	$	125,000	$	
Supplemental disclosures of noncash investing and financing activities:				
Accretion of Series C Preferred Stock dividends	$	336,080	$	336,080
Accretion of Series D Preferred Stock dividends	$	605,362	$	605,362

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1. Nature of Organization

Voice Signal Technologies, Inc. and Subsidiaries (VoiceSignal or the Company) consists of Voice Signal Technologies, Inc., a Delaware corporation and four wholly-owned subsidiaries. The Company is a privately held corporation based in Woburn, Massachusetts. Its subsidiaries consist of Voice Signal Technologies OY, which is located in Finland, and VoiceSignal KK, which is located in Japan, both foreign corporations, as well as Voice Signal Korea, Inc., located in Korea, and Voice Signal International, Inc., located in China and England, both Massachusetts corporations.

VoiceSignal develops state-of-the-art small footprint, highly accurate, speech solutions for use on wireless mobile devices. VoiceSignal licenses its solutions to original equipment manufacturers (OEMs) of mobile information devices (phones, handhelds) and directly to consumers of mobile devices.

The accompanying interim consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles. In the opinion of management, these interim consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the financial position of the Company at June 30, 2007, the results of operations and cash flows for the three month and six month periods ended June 30, 2007 and 2006. The accompanying financial statements should be read in conjunction with the audited financial statements and notes thereto as of December 31, 2006 and for the three years then ended. The results for the three month period and six month period ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007, or any future period.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Principles of Consolidation

The consolidated financial statements reflect the consolidated results of Voice Signal Technologies, Inc. and Subsidiaries for the three and six months ended June 30, 2007 and 2006. All significant intercompany accounts and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

The Company considers short-term investments with original maturity dates of three months or less at the date of purchase to be cash equivalents. The Company s cash equivalents as of June 30, 2007 and December 31, 2006 primarily consisted of funds deposited at financial institutions within the United States.

Accounts Receivable

Accounts receivable are stated at the amount management expects to collect from outstanding balances. Allowances for doubtful accounts are provided for those outstanding balances considered to be uncollectible based upon management s evaluation of the outstanding balances.

Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance for doubtful accounts. The Company has determined all amounts outstanding to be collectible and has not recorded an allowance at June 30, 2007 and December 31, 2006.

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Revenue Recognition

In accordance with the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, as amended by SOP No. 98-9, *Software Revenue Recognition, With Respect to Certain Transactions,* revenue from sales of software products is recognized when persuasive evidence of an arrangement exists, delivery of the product has occurred, no significant Company obligations with regard to the product s functionality remain, the fee is fixed or determinable and collectibility is probable. Substantially all of the Company s revenues are derived from multiple element arrangements that include royalty fees, professional services, and licenses fees. The Company has not established vendor specific objective evidence (VSOE) for the fair values of the individual elements in its multiple element contracts. For those arrangements that require customers to make large initial payments under multiple element contracts, the Company recognizes the revenue from the initial payments ratably over the period the Company expects to provide services which is either the term of the respective agreement or the units shipped, provided the agreement specifies a fixed number of units. Additional payments received from customers during the term of the contracts for professional services or royalties are recognized as the services are provided or units are shipped to the customer, provided all other elements are delivered.

Income Taxes

The Company accounts for income taxes utilizing the asset and liability method as prescribed by Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes.* Under the provisions of SFAS No. 109, the current or deferred tax consequences of a transaction are measured by applying the provisions of enacted tax laws to determine the amount of taxes payable currently or in future years. The classification of net current and noncurrent deferred tax assets or liabilities depend upon the nature of the related asset or liability. Deferred income taxes are provided for temporary differences between the income tax basis of assets and liabilities and their carrying amounts for financial reporting purposes. In addition, deferred taxes are recognized for operating losses that are available to offset future taxable income. A valuation allowance is established when necessary to reduce deferred tax assets to the amounts expected to be realized.

In June 2006, the Financial Accounting Standards Board, or FASB, issued Interpretation No. 48, or FIN No. 48, *Accounting for Income Tax Uncertainties*, which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. The Interpretation prescribes a recognition threshold of more-likely-than-not and a measurement attribute on all tax positions taken or expected to be taken in a tax return in order to be recognized in the financial statements. In making this assessment, a company must determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based solely on the technical merits of the position and that the tax position will be examined by appropriate taxing authority that would have full knowledge of all relevant information. Once the recognition threshold is met, the tax position is then measured to determine the actual amount of benefit to recognize in the financial statements. In addition, the recognition threshold of more-likely-than-not must continue to be met in each reporting period to support continued recognition of the tax benefit. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the financial reporting period in which that threshold is no longer met. The Company adopted FIN No. 48 effective January 1, 2007, and there was no impact to the Company s financial statements.

Research and Software Development Costs

Research and development expenditures incurred in the development of software products and enhancements to existing software products are expensed to operations as incurred until the point the Company establishes technological feasibility in accordance with SFAS No. 86, *Accounting for Software to be Sold, Licensed or Otherwise Marketed to Others*. Technical feasibility is established upon the completion of a working model or a detailed program design as defined by SFAS No. 86. Costs incurred by the Company between establishment of technological feasibility and the point at which the product is ready for general release are capitalized, subject to their recoverability, in accordance with SFAS No. 86 and amortized over the economic life of the related product. The Company has not capitalized any software development costs as of the balance sheet date as the costs eligible for capitalization are immaterial.

Concentration of Credit Risk and Significant Customers

The Company maintains its cash and cash equivalents in bank deposit accounts, which at times may exceed federally insured limits. The Company believes it is not exposed to any significant credit risk on cash and cash equivalents. For the three months ended June 30, 2007 and 2006, the Company generated approximately 91% and 95%, respectively, of its revenues from two customers. For the six months ended June 30, 2007 and 2006, the Company generated approximately 90% and 95%, respectively, of its revenues from two customers. Total accounts receivable from these two customers as of June 30, 2007 and December 31, 2006 amounted to approximately 93% and 98% respectively.

3. Intangible Assets

During 2005, the Company entered into a Data License Agreement (License Agreement) with a software vendor to purchase a royalty-free, worldwide, exclusive license to use in the design, development, production, commercialization, and maintenance of the Company s products. Under the License Agreement, the Company committed to purchase a set number of data language licenses for a total contract value of $2,600,000. The licenses, under the License Agreement, are recorded at cost and are amortized on a straight-line basis over the useful life beginning when the assets are placed in service. At June 30, 2007 and December 31, 2006, the licenses of $2,331,910, net of accumulated amortization of $699,572 and $466,382, respectively, are included in intangible assets on the accompanying consolidated balance sheets.

During 2006, the Company entered into a Patent License Agreement with a not-for-profit corporation to purchase a worldwide, exclusive license. The license, under the Patent License Agreement, is recorded at cost and is amortized on a straight-line basis over the useful life beginning when the asset is placed in service. The license of $182,956, net of accumulated amortization of $26,265 and $7,968 at June 30, 2007 and December 31, 2006, respectively, is included in intangible assets on the accompanying consolidated balance sheets.

4. License Obligation

The Company financed the purchase of the Data License Agreement (Note 3) over a five year period. At June 30, 2007 and December 31, 2006, the present value of the related liability, plus accrued interest, is $1,817,195 and $1,770,718, net of payments of $676,000 made in 2005. The liability is recorded as a license obligation on the accompanying consolidated balance sheets based on the minimum purchase commitments over the term of the commitment utilizing an interest rate of 7.25%.

Maturities of the data license agreement for the years ending December 31 are as follows:

2007 (July 1, 2007 to December 31, 2007)	$	918,750
2008		555,000
2009		361,000
2010		89,250
		1,924,000
Less amount representing interest		106,805

Present value of future payments		1,817,195
Less current portion of data license obligation		1,031,497
Data license obligation, net of current portion	$	785,698

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The Company is required to make payments on the purchase of the patent licenses throughout 2007. The obligation, plus accrued interest, is recorded in accounts payable on the accompanying consolidated balance sheets utilizing an interest rate of 8.25% at June 30, 2007.

5. Commitments and Contingencies

The Company is involved in various legal matters, which have arisen in the ordinary course of business. The Company does not believe that the ultimate resolution of these matters will have a material adverse effect on the financial condition, results of operations or cash flows. The Company believes these litigation matters are without merit and intends to defend these matters vigorously.

6. Stockholders Deficit

At June 30, 2007, the Company is authorized to issue 128,000,000 and 80,084,844 shares of common stock and preferred stock, $.001 par value, respectively. The preferred stock consists of 5,600,000 shares designated as Series A Convertible Preferred Stock (Series A Preferred Stock), 1,820,000 shares designated as Series B Convertible Preferred Stock (Series B Preferred Stock), 6,383,294 shares designated as Series C Redeemable Convertible Preferred Stock (Series C Preferred Stock), and 66,281,550 shares designated as Series D Redeemable Convertible Preferred Stock (Series D Preferred Stock).

As of June 30, 2007, the Company has reserved for issuance the following shares of common stock for the exercise of stock options and the conversion of preferred stock:

Stock options	24,727,315
Convertible preferred stock	80,084,844
	104,812,159

7. Preferred Stock

The holders of the Series C Preferred Stock and Series D Preferred Stock (Senior Preferred Stock) shall be entitled to receive cumulative dividends equal to $0.1053 per annum per share for Series C Preferred Stock and equal to $0.0182664 per annum per share for Series D Preferred Stock. The dividends will accrue daily in arrears whether or not such dividends are declared by the Board of Directors. At June 30, 2007 and December 31, 2006, cumulative unpaid dividends for Series C Preferred Stock totaled $4,776,024 and $4,439,944, respectively, and cumulative unpaid dividends for Series D Preferred Stock totaled $5,109,169 and $4,503,807, respectively.

The holders of the Series A Preferred Stock and Series B Preferred Stock (Junior Preferred Stock) shall be entitled to receive dividends, if and when, as declared by the Board of Directors, out of funds legally available for that purpose after the payment of all accrued and unpaid dividends to the holder of each share of Senior Preferred Stock.

In the event of any liquidation, dissolution or winding-up of the Company, the Series A, Series B, and Series C Preferred Stockholders shall receive a per share amount equal to the original issue price of the respective Series and dividends and the Series D Preferred Stockholders shall receive a per share amount equal to two times the Series D Preferred Stock original issue price, plus all declared and unpaid dividends.

Each share of Preferred Stock, at the option of the holder, is convertible into fully paid and nonassessable shares of voting common stock initially on a share-for-share basis. The Junior Preferred Stockholders are entitled to payment of any declared and unpaid dividends. The Senior Preferred Stockholders have the right to convert any accrued but unpaid dividends on the Senior Preferred Stock into the number shares of voting common stock based on a predetermined ratio, as defined in the Preferred Stock Agreement.

All series of Preferred Stock automatically converts to common stock upon the closing of an initial public offering at a share price not less than $2.50 per share and with net proceeds of at least $50,000,000.

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At any time on or after September 30, 2007, a Senior Majority Interest, as defined, may elect to have redeemed up to one-third of the originally issued and outstanding shares of Series C Preferred Stock and Series D Preferred Stock held by each holder at such time.

At any time on or after September 30, 2008, a Senior Majority Interest may elect to have redeemed up to that percentage of outstanding shares of Series C Preferred Stock and Series D Preferred Stock that would, when combined with any prior redemptions, result in the redemption by the Company of up to two-thirds of each of the originally issued and outstanding shares of Series C Preferred Stock and Series D Preferred Stock held by each holder of Senior Preferred Stock at such time.

At any time on or after September 30, 2009, a Senior Majority Interest may elect to have redeemed up to that percentage of outstanding shares of Series C Preferred Stock and Series D Preferred Stock that would, when combined with any prior redemptions, result in the redemption by the Company of up to one hundred percent (100%) of the originally issued and outstanding shares of Series C Preferred Stock and Series D Preferred Stock held by each holder thereof at such time.

The price for each share of Senior Preferred Stock redeemed shall be the greater of (i) an amount equal to the Series C Preferred Stock or Series D Preferred Stock Original Issue Price plus all accrued but unpaid dividends or (ii) the Fair Market Value of such shares of Senior Preferred Stock. The aggregate Redemption Prices shall be payable in cash in immediately available funds to the holders of the Senior Preferred Stock on the applicable redemption date.

The Series C and Series D Preferred Stock are not considered mandatorily redeemable as defined by Statement of Financial Accounting Standards (SFAS) 150, *Accounting for Certain Financial Instruments with characteristics of Both Liabilities and Equity*. Due to the fact that the redemption is in the control of the stockholders, the Series C and D Preferred stock have been classified in the mezzanine section of the consolidated balance sheet.

8. Stock Option Plan

In 1998, the Company adopted the 1998 Stock Plan (the Plan) under which shares of the Company s common stock were reserved for issuance to employees, directors and consultants. Stock based awards granted under the Plan may be incentive stock options or nonstatutory stock options. Incentive stock options may only be granted to employees. Under the terms of the Plan, the Board of Directors shall specify the exercise price and vesting period of each stock option on the grant date, and certain options are exercisable upon the occurrence of a future event. The Plan authorizes the issuance of up to 24,727,315 shares of common stock. Typical vesting of the options is four years; 25% on the anniversary of the Effective Date and the remaining 75% of the shares at the rate of 1/12 per quarter over the next twelve quarters. The options generally expire at the earlier of ninety days from the end of employment or ten years from the date of grant.

At June 30, 2007, 3,503,431 shares were available for grant under the Plan. The following table summarizes the activity under the Plan:

	Number of Options	Weighted Average Exercise Price
Outstanding, December 31, 2006	20,026,153	$ 0.12
Issued	25,000	0.11

Exercised	(134,375)		0.22
Forfeited	(596,063)		0.09
Outstanding, June 30, 2007	19,320,715	$	0.12
Options exercisable at June 30, 2007	17,388,037	$	0.12

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9. Related Party

The Company has an investor who is a partner at the law firm that provides services as primary counsel for the Company. Legal fees incurred in connection with services provided by this law firm for the three months and six months ended June 30, 2007 were approximately $672,000, and $823,000, respectively of which approximately $17,800 and $100,600 are recorded in general and administrative expenses respectively on the accompanying consolidated statements of income. Legal fees incurred in connection with services provided by this law firm for the three months and six months ended June 30, 2006 were approximately $11,200, and $24,800 which is recorded in general and administrative expenses on the accompanying consolidated statements of income. The remaining legal fees are included in prepaid expenses and other current assets on the accompanying consolidated balance sheets as they relate to transaction costs (Note 10).

10. Planned Merger Agreement

On May 14, 2007, the Company entered into an agreement and plan of merger with Nuance Communications, Inc. Related transaction costs of $807,982 and $0 at June 30, 2007 and December 31, 2006, respectively, are included in prepaid expenses and other current assets on the accompanying consolidated balance sheets. In the event that the merger is not consummated by November 14, 2007, the parties may terminate the agreement for any reason and Nuance will reimburse the Company for up to $1,000,000 in transaction related expenses.

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Voice Signal Technologies, Inc.

Annual Financial Statements

VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS
For the years ended December 31, 2006, 2005 and 2004

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INDEPENDENT AUDITORS   REPORT

To the Board of Directors of
Voice Signal Technologies, Inc. and Subsidiaries
Woburn, Massachusetts

We have audited the accompanying consolidated balance sheets of Voice Signal Technologies, Inc. and Subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, changes in redeemable convertible preferred stock, stockholders   deficit and comprehensive income (loss), and cash flows for each of the three years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company   s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Voice Signal Technologies, Inc. and Subsidiaries as of December 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years ended December 31, 2006, 2005 and 2004 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standard No. 123(R),   Share-Based Payment.

VITALE, CATURANO & COMPANY, LTD.

May 11, 2007
Boston, Massachusetts

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
Years Ended December 31, 2006 and 2005

	2006	2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,982,789	$ 296,816
Short term investments	3,000,000	6,117,213
Accounts receivable	6,130,653	3,468,463
Prepaid expenses and other current assets	417,173	502,043
Deferred tax asset	3,624,000	3,222,000
Total current assets	17,154,615	13,606,535
Property and equipment, net	739,861	530,303
Other assets:		
Intangible assets, net	2,040,516	2,331,910
Other noncurrent assets	188,051	483,087
	2,228,567	2,814,997
	$ 20,123,043	$ 16,951,835
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS DEFICIT		
Current liabilities		
Accounts payable	$ 926,403	$ 712,685
Accrued expenses and other current liabilities	966,464	981,856
License obligation, current portion	894,043	344,010
Deferred revenue, current portion	5,645,714	8,389,905
Capital lease obligation, current portion	23,259	
Total current liabilities	8,455,883	10,428,456
License obligation, net of current portion	876,675	1,311,900
Capital lease obligation, net of current portion	15,319	
Deferred revenue, net of current portion	1,507,810	3,555,787
Total liabilities	10,855,687	15,296,143
Commitments and contingencies (Note 8)		
Redeemable convertible preferred stock:		
Series C redeemable convertible preferred stock, $.001 par value; 6,383,294 shares authorized, issued and outstanding (at redemption value; liquidation preference of $12,845,467)	12,768,200	12,096,039

Series D redeemable convertible preferred stock, $.001 par value; 66,281,550 shares authorized, issued and outstanding (at redemption value; liquidation preference of $32,816,093)	19,473,944	18,263,219
Total redeemable convertible preferred stock	32,242,144	30,359,258
Stockholders deficit:		
Series A convertible preferred stock, $.001 par value; 5,600,000 shares authorized, issued and outstanding (liquidation preference of $560,000)	5,600	5,600
Series B convertible preferred stock, $.001 par value; 1,820,000 shares authorized, issued and outstanding (liquidation preference of $699,999)	1,820	1,820
Common stock, $.001 par value; 128,000,000 shares authorized; 17,228,794 and 16,570,819 shares issued and outstanding at December 31, 2006 and 2005 respectively	17,229	16,571
Additional paid-in capital	1,795,483	1,580,759
Deferred compensation		(16,372)
Accumulated deficit	(24,784,382)	(30,283,740)
Accumulated other comprehensive loss	(10,538)	(8,204)
Total stockholders deficit	(22,974,788)	(28,703,566)
	$ 20,123,043	$ 16,951,835

See accompanying notes.

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
Years Ended December 31, 2006, 2005 and 2004

	2006	2005	2004
Revenues:			
Royalty	$ 20,374,916	$ 8,755,391	$ 5,424,352
Professional services	3,082,257	1,684,608	959,123
License	1,144,255	1,300,927	1,083,305
Total revenues	24,601,428	11,740,926	7,466,780
Cost of revenues:			
Cost of revenue from amortization of intangible assets	474,350		
Cost of professional services	1,350,678	1,327,682	494,574
Total cost of revenues	1,825,028	1,327,682	494,574
Gross profit	22,776,400	10,413,244	6,972,206
Operating expenses:			
Research and development	6,000,678	5,351,616	4,088,227
General and administrative	5,356,430	4,293,850	2,739,078
Sales and marketing	4,214,434	4,071,809	3,131,120
	15,571,542	13,717,275	9,958,425
Income (loss) from operations	7,204,858	(3,304,031)	(2,986,219)
Interest income	144,462	206,589	44,164
Interest expense	(154,667)	(397)	
Income (loss) before income taxes	7,194,653	(3,097,839)	(2,942,055)
Benefit for income taxes	187,591	3,210,452	
Net income (loss)	$ 7,382,244	$ 112,613	$ (2,942,055)

See accompanying notes.

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN REDEEMABLE CONVERTIBLE PREFERRED STOCK, STOCKHOLDERS DEFICIT AND COMPREHENSIVE INCOME (LOSS)
Years Ended December 31, 2006, 2005 and 2004

Series D deemable Convertible Preferred Stock		Series A Convertible Preferred Stock		Series B Convertible Preferred Stock		Common Stock		Paid-in	Defer
ares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Capital	Compens
142,408	$ 14,923,859	5,600,000	$ 5,600	1,820,000	$ 1,820	15,950,350	$ 15,950	$ 1,511,052	$ (57,
						537,439	538	37,782	
139,142	933,560								
	1,195,075								
								12,262	(12,
									48,
281,550	17,052,494	5,600,000	5,600	1,820,000	1,820	16,487,789	16,488	1,561,096	(21,
						83,030	83	7,390	
	1,210,725								
								12,273	(12,
									17,

281,550	18,263,219	5,600,000	5,600	1,820,000	1,820	16,570,819	16,571	1,580,759	(16,
						657,975	658	53,406	
	1,210,725								
								(16,372)	16,
								77,857	
								99,833	
281,550	$ 19,473,944	5,600,000	$ 5,600	1,820,000	$ 1,820	17,228,794	$ 17,229	$ 1,795,483	$

See accompanying notes.

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2006, 2005 and 2004

	2006	2005	2004
Cash flows from operating activities:			
Net income (loss)	$ 7,382,244	$ 112,613	$ (2,942,055)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation expense	324,401	249,093	182,314
Amortization expense	474,350		
Stock-based compensation	177,690	17,342	48,155
Deferred income taxes	(402,000)	(3,222,000)	
Non-cash interest expense	119,307		
Changes in assets and liabilities:			
(Increase) decrease in:			
Accounts receivable	(2,662,190)	1,991,354	(5,165,848)
Prepaid expenses and other current assets	84,870	(359,793)	(93,340)
Other assets	292,953	(278,024)	(79,200)
Increase (decrease) in:			
Accounts payable	76,076	6,999	390,151
Accrued expenses and other current liabilities	(15,392)	33,198	670,900
Deferred revenue	(4,792,168)	7,037,410	3,088,298
Net cash provided by (used in) operating activities	1,060,141	5,588,192	(3,900,625)
Cash flows from investing activities:			
Redemption of short term investment	3,117,213		
Purchase of short term investment		(6,117,213)	
Acquisitions of property and equipment	(485,278)	(463,924)	(161,207)
Acquisition of patent license	(47,730)		
Payments on data license		(676,000)	
Net cash provided by (used in) investing activities	2,584,205	(7,257,137)	(161,207)
Cash flows from financing activities:			
Proceeds from exercising stock options	54,064	7,473	38,320
Proceeds from issuance of preferred stock			933,560
Payments on loan obligations	(13,077)		
Net cash provided by financing activities	40,987	7,473	971,880
Effect of change in exchange rates on cash	640	(811)	
Net increase (decrease) in cash and cash equivalents	3,685,973	(1,662,283)	(3,089,952)
Cash and cash equivalents, beginning of year	296,816	1,959,099	5,049,051

Cash and cash equivalents, end of year	$ 3,982,789	$ 296,816	$ 1,959,099
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	$ 154,667	$ 397	$
Income taxes	$ 168,418	$	$
Supplemental disclosures of noncash investing and financing activities:			
Accounts payable incurred to acquire patent	$ 135,226	$	$
Capital lease obligation assumed in acquisition of property and leased equipment	$ 51,665	$	$
Accretion of Series C Preferred Stock dividends	$ 672,161	$ 672,161	$ 672,161
Accretion of Series D Preferred Stock dividends	$ 1,210,725	$ 1,210,725	$ 1,195,075
Obligation assumed in acquisition of data license	$	$ 1,655,910	$

See accompanying notes.

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2006, 2005 and 2004

1. Nature of Organization

Voice Signal Technologies, Inc. and Subsidiaries (VoiceSignal or the Company) consists of Voice Signal Technologies, Inc., a Delaware corporation and four wholly-owned subsidiaries. The Company is a privately held corporation based in Woburn, Massachusetts. Its subsidiaries consist of Voice Signal Technologies OY, which is located in Finland, and VoiceSignal KK, which is located in Japan, both foreign corporations, as well as Voice Signal Korea, Inc., located in Korea, and Voice Signal International, Inc., located in China and England, both Massachusetts corporations.

VoiceSignal develops state-of-the-art small footprint, highly accurate, speech solutions for use on wireless mobile devices. VoiceSignal licenses its solutions to original equipment manufacturers (OEMs) of mobile information devices (phones, handhelds) and directly to consumers of mobile devices.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements reflect the consolidated results of Voice Signal Technologies, Inc. and Subsidiaries for the years ended December 31, 2006, 2005 and 2004. All significant intercompany accounts and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

The Company considers short-term investments with original maturity dates of three months or less at the date of purchase to be cash equivalents. The Company s cash equivalents as of December 31, 2006 and 2005 primarily consisted of funds deposited at financial institutions within the United States.

Short-Term Investments

As of December 31, 2006 and 2005, the Company s short-term investments include certificates of deposits held with a financial institution. The certificate of deposit at December 31, 2006 matures during 2007. The certificate of deposit that was recorded at December 31, 2005 matured in 2006. At December 31, 2005, the amount recorded on the accompanying consolidated balance sheets includes interest receivable of approximately $17,000.

Accounts Receivable

Accounts receivable are stated at the amount management expects to collect from outstanding balances. Allowances for doubtful accounts are provided for those outstanding balances considered to be uncollectible based upon management s evaluation of the outstanding balances at year end. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance for doubtful accounts. The Company has determined all amounts outstanding to be collectible and has not recorded an allowance for the years ended December 31, 2006 and 2005.

Property and Equipment

Property and equipment are recorded at cost. Major replacements and improvements are capitalized, while general repairs and maintenance are charged to expense as incurred. The Company provides for

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2006, 2005 and 2004 (Continued)

depreciation using the straight-line method, beginning in the middle of the quarter the asset is placed in service, over the estimated useful lives of the assets as follows:

Computers equipment and software	3 years
Furniture and fixtures	5 years
Equipment	5 years
Leasehold improvements	Lesser of useful life or life of the lease

Revenue Recognition

In accordance with the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, as amended by SOP No. 98-9, *Software Revenue Recognition, With Respect to Certain Transactions,* revenue from sales of software products is recognized when persuasive evidence of an arrangement exists, delivery of the product has occurred, no significant Company obligations with regard to the product s functionality remain, the fee is fixed or determinable and collectibility is probable. Substantially all of the Company s revenues are derived from multiple element arrangements that include royalty fees, professional services, and licenses fees. The Company has not established vendor specific objective evidence (VSOE) for the fair values of the individual elements in its multiple element contracts. For those arrangements that require customers to make large initial payments under multiple element contracts, the Company recognizes the revenue from the initial payments ratably over the period the Company expects to provide services, which is either the term of the respective agreement or the units shipped, provided the agreement specifies a fixed number of units. Additional payments received from customers during the term of the contracts for professional services or royalties are recognized as the services are provided or units are shipped to the customer, provided all other elements are delivered.

Deferred Costs of Professional Services

The commissions expense incurred in its multiple element arrangements are deferred and expensed ratably as the related revenue is recognized either over the term of the contract or as the units shipped. As of December 31, 2006, 2005 and 2004, these deferred costs totaled approximately $348,000, $774,000 and $183,000, respectively, and are included in prepaid expenses and other current assets and other noncurrent assets in the accompanying balance sheets.

Income Taxes

The Company accounts for income taxes utilizing the asset and liability method as prescribed by SFAS No. 109, *Accounting for Income Taxes.* Under the provisions of SFAS No. 109, the current or deferred tax consequences of a transaction are measured by applying the provisions of enacted tax laws to determine the amount of taxes payable currently or in future years. The classification of net current and noncurrent deferred tax assets or liabilities depend upon the nature of the related asset or liability. Deferred income taxes are provided for temporary differences between the income tax basis of assets and liabilities and their carrying amounts for financial reporting purposes. In addition, deferred taxes are recognized for operating losses that are available to offset future taxable income. A valuation allowance is established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Research and Software Development Costs

Research and development expenditures incurred in the development of software products and enhancements to existing software products are expensed to operations as incurred until the point the Company establishes technological feasibility in accordance with Statement of Financial Accounting Standards (SFAS)

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2006, 2005 and 2004 (Continued)

No. 86, *Accounting for Software to be Sold, Licensed or Otherwise Marketed to Others* (SFAS No. 86). Technical feasibility is established upon the completion of a working model or a detailed program design as defined by SFAS No. 86. Costs incurred by the Company between establishment of technological feasibility and the point at which the product is ready for general release are capitalized, subject to their recoverability, in accordance with SFAS No. 86 and amortized over the economic life of the related product. The Company has not capitalized any software development costs as of the balance sheet date as the costs eligible for capitalization are immaterial.

Stock-Based Compensation

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standard No. 123 (revised 2004), *Share Based Payment*, or SFAS No. 123(R), which is a revision of Statement No. 123 (SFAS 123) *Accounting for Stock Based Compensation.* SFAS No. 123(R) supersedes Accounting Principles Board (APB) No. 25, *Accounting for Stock Issued to Employees*, and amends FASB Statement No. 95 *Statement of Cash Flows.* SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options and modifications to existing stock options, to be recognized in the income statement based on their fair values. The Company adopted SFAS No. 123(R) using the prospective transition method. As such, the Company will continue to apply APB No. 25 in future periods to equity awards outstanding at the date of SFAS No. 123(R) s adoption that were measured using the minimum value method. Pro forma disclosure is no longer an alternative. The Company is currently evaluating the impact the adoption of SFAS No. 123(R) will have on the Company s operating results for periods after December 31, 2006, but the impact of adoption of SFAS No. 123(R) cannot be predicted with certainty as it is principally a function of the number of options to be granted in the future, the share price on the date of the grant, the expected life of the award, and volatility and estimated forfeitures. The adoption of SFAS No. 123(R) will have no effect on our financial position or cash flow for any period.

Prior to January 1, 2006, the Company applied Accounting Principles Board APB Opinion No. 25, Accounting for Stock Issued to Employees in accounting for its stock incentive plan and accordingly, compensation cost was recognized for its stock options in the financial statements when the exercise price was below the fair market value. During the years ended December 31, 2005 and 2004, approximately $17,000 and $48,000, respectively, were recorded under the intrinsic value based method for options granted to consultants (Note 12). Had the Company determined compensation cost in all periods based on the fair value at the grant date for its stock options under SFAS No. 123R, the Company s net income (loss) and net income (loss) per common equivalent share for the years ended December 31, 2005 and 2004 would have been increased to the pro forma amounts indicated below:

	2005			
	Net Income (Loss) Applicable to Common Stockholders (Basic)	Basic Earnings Per Share	Net Income (Loss) Applicable to Common Stockholders (Diluted)	Diluted Earnings Per Share

As reported	$	(1,770,273)	$	(0.11)	$	112,613	$	(0.11)
Add stock-based compensation expense included in reported net income (loss)		17,342		(0.00)		17,342		(0.00)
Less stock-based compensation expense determined under fair value method		(168,608)		(0.01)		(168,608)		(0.00)
Pro forma		(1,921,539)	$	(0.12)	$	(38,653)	$	(0.11)

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2006, 2005 and 2004 (Continued)

	2004			
	Net Income (Loss) Applicable to Common Stockholders (Basic)	Basic Earnings Per Share	Net Income (Loss) Applicable to Common Stockholders (Diluted)	Diluted Earnings Per Share
As reported	$ (4,809,291)	$ (0.30)	$ (2,942,052)	$ (0.30)
Add stock-based compensation expense included in reported net loss	48,155	(0.00)	171,243	(0.00)
Less stock-based compensation expense determined under fair value method	(219,398)	(0.01)	(171,243)	(0.00)
Pro forma	(4,980,534)	$ (0.31)	$ (2,942,052)	$ (0.30)

For the years ending December 31, the fair value of each stock option is estimated on the date of the grant using the Black-Scholes option-pricing model with the following range of assumptions:

	2006	2005	2004
Assumptions:			
Risk-free interest rate	4.66-5.19%	3.70-4.74%	3.89-4.61%
Expected dividend yield	0%	0%	0%
Volatility factor	68-77%	0%	0%
Expected life of option	4.84-6.11 years	10 years	10 years

In accordance with SFAS No. 123(R), the Company will recognize the compensation cost of share-based awards issued after January 1, 2006, on a straight-line basis over the vesting period of the award. The determination of the fair value of share-based payment awards utilizing the Black-Scholes model is affected by the stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. The Company does not have a history of market prices of the common stock as it is not a public company, and as such volatility is estimated in accordance with Staff Accounting Bulletin No. 107 (SAB No. 107) using historical volatilities of similar public entities. The expected life of the awards is estimated based on the simplified method, as defined in SAB No. 107. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of our awards. The dividend yield assumption is based on history and expectation of paying no dividends. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Stock-based compensation expense recognized in the financial statements in 2006 and thereafter is based on awards that are ultimately expected to vest.

The weighted-average fair value of stock options granted during the years ended December 31, 2006, 2005 and 2004 under the Black-Scholes option pricing model were $0.93, $0.09 and $0.09 per share, respectively. For the year ended December 31, 2006, the Company recorded stock-based compensation expense of $99,833 in connection with share-based payment awards. The following table presents stock-based compensation expense included in the accompanying consolidated statements of income:

Research and development	$ 25,210
General and administrative	59,335
Sales and marketing	15,288
Total stock-based compensation expense	$ 99,833

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2006, 2005 and 2004 (Continued)

As of December 31, 2006, there was approximately $421,000 of unrecognized compensation expense related to non-vested stock option awards that is expected to be recognized over a weighted-average period of 3.21 years.

Foreign Currency Translation

The functional currency of the Company s foreign subsidiary is the local currency. Assets and liabilities of foreign subsidiaries are translated at the rates in effect at the balance sheet date, while stockholders equity (deficit) is translated at historical rates. Statements of operations and cash flow amounts are translated at the average rate for the period. Translation adjustments are included as a component of accumulated other comprehensive loss. Foreign currency gains and losses arising from transactions are reflected in the loss from operations and were not significant during the years ended December 31, 2006, 2005 and 2004.

Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Concentration of Credit Risk and Significant Customers

The Company maintains its cash and cash equivalents in bank deposit accounts, which at times may exceed federally insured limits. The Company believes it is not exposed to any significant credit risk on cash and cash equivalents. For the years ended December 31, 2006, 2005 and 2004, the Company generated approximately 95%, 87% and 94%, respectively, of its revenues from two customers. Total accounts receivable from these two customers as of December 31, 2006 and 2005 amounted to approximately 98% and 88%, respectively.

Segmentation of Financial Results

The Company s primary operating decision makers evaluate the Company s financial performance using consolidated financial information. Accordingly, the Company presents its financial results as a single segment related to the sale of its products.

Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48 (FIN 48), *Accounting for Income Tax Uncertainties*, which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes*. The Interpretation prescribes a recognition threshold of more-likely-than-not and a measurement attribute on all tax positions taken or expected to be taken in a tax return in order to be recognized in the financial statements. In making this assessment, a company must determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based solely on the technical merits of the position and that the tax position will be examined by appropriate taxing authority that would have full knowledge of all relevant information. Once the recognition threshold is met, the tax position is then measured to determine the actual amount of benefit to recognize in the financial statements. In addition, the recognition threshold of more-likely-than-not must continue to be met in each reporting period to support continued recognition of the tax benefit. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be

VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2006, 2005 and 2004 (Continued)

recognized in the first financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the financial reporting period in which that threshold is no longer met. The Company adopted FIN 48 effective January 1, 2007, and there was no impact to the Company s financial statements.

3. Property and Equipment

Property and equipment consisted of the following at December 31:

	2006	2005
Computer equipment and software	$ 1,515,557	$ 1,074,058
Furniture and fixtures	256,965	256,965
Leasehold improvements	214,146	121,685
Equipment	24,881	24,881
	2,011,549	1,477,589
Less accumulated depreciation	1,271,688	947,286
	$ 739,861	$ 530,303

4. Intangible Assets

During 2005, the Company entered into a Data License Agreement (License Agreement) with a software vendor to purchase a royalty-free, worldwide, exclusive license to use in the design, development, production, commercialization, and maintenance of the Company s products. Under the License Agreement, the Company committed to purchase a set number of data language licenses for a total contract value of $2,600,000 (Note 6). The licenses, under the License Agreement, are recorded at cost and are amortized on a straight-line basis over the useful life beginning when the assets are placed in service. At December 31, 2006 and 2005, the licenses of $2,331,910, net of accumulated amortization of $466,382 and $0, respectively, are included in intangible assets, net, on the accompanying consolidated balance sheets.

During 2006, the Company entered into a Patent License Agreement with a not-for-profit corporation to purchase a worldwide, exclusive license. The license, under the Patent License Agreement, is recorded at cost and is amortized on a straight-line basis over a useful life of 5 years beginning when the asset is placed in service. At December 31, 2006, the license of $182,956, net of accumulated amortization of $7,968 is included in intangible assets, net, on the accompanying consolidated balance sheets.

Amortization expense for the year ended December 31, 2006 was $474,350 and is included in cost of revenues. There was no amortization expense in the years ended December 31, 2005 and 2004. The estimated aggregate amortization expense for the years ending December 31, 2007, 2008, 2009, 2010 and 2011 is $502,975, $502,975, $502,975,

$502,975 and $28,616.

5. Line of Credit

In November 2006, the Company entered into an agreement with a financial institution to provide a revolving line of credit with a borrowing base of $1,500,000 plus 80% of the Company s accounts receivable balance billed with-in the prior 90 days, up to a total available balance of $5,000,000. Borrowings under the line of credit bear interest at the bank s prime rate plus one-half of one percent (8.75% at December 31, 2006). As of December 31, 2006, the Company had no borrowings under this revolving line of credit. The Company has capitalized $50,000 in deferred financing fees during 2006 and will expense these fees ratably over the term of the revolving line of credit. The amortization of the deferred financing fees was $2,083 for

VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2006, 2005 and 2004 (Continued)

the year ended December 31, 2006 and is recorded in interest expense on the accompanying consolidated statements of operations.

The line of credit has an original term of 24 months and is subject to certain restrictive covenants. The most significant covenants relate to maintaining certain financial ratios, prohibiting change of control without the consent of the bank, requiring certain periodic reporting and limiting certain other transactions.

6. License Obligation

The Company financed the purchase of the Data License Agreement (Note 4) over a five year period. At December 31, 2006 and 2005, the present value of the related liability, plus accrued interest, is $1,770,718 and $1,655,910, net of payments of $676,000 made in 2005. The liability is recorded as a license obligation on the accompanying balance sheets based on the minimum purchase commitments over the term of the commitment utilizing an interest rate of 7.25%.

Maturities of the data license agreement for the years ending December 31 are as follows:

2007	$ 918,750
2008	555,000
2009	361,000
2010	89,250
	1,924,000
Less amount representing interest	153,282
Present value of future payments	1,770,718
Less current portion of data license obligation	894,043
Data license obligation, net of current portion	$ 876,675

The Company is required to make payments on the purchase of the patent licenses throughout 2007. The obligation, plus accrued interest, is recorded in accounts payable on the accompanying consolidated balance sheets utilizing an interest rate of 8.25% at December 31, 2006.

7. Capital Lease Obligations

In 2006, the Company entered into a noncancelable capital lease agreement for computer equipment. The lease will expire on July 2008. The terms of the lease call for 24 monthly interest free installments. Interest has been recorded using the effective interest method at 8%. The Company recorded the property and equipment at $51,665. Depreciation expense relating to the Company s assets under capital lease was $6,457 for the year ending December 31, 2006. There were no capital leases at December 31, 2005.

VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2006, 2005 and 2004 (Continued)

Future minimum payments required under the lease obligation for the years ending December 31 are as follows:

2007	$ 25,505
2008	15,728
	41,233
Less amount representing interest	2,655
Present value of future minimum payments	38,578
Less current portion of obligation under capital lease	23,259
Long-term portion of obligation under capital lease	$ 15,319

8. Commitments and Contingencies

Leases

The Company leases certain offices and development facilities and an automobile under noncancelable operating leases that expire over the next three years. Total rental expense for operating leases approximated $326,753, $300,268 and $298,720 for the years ended December 31, 2006, 2005 and 2004, respectively.

The Company s lease agreement at the Woburn location requires future increases in the minimum base rent. Rent expense under this arrangement is recognized on the straight-line basis over the term of the lease. The difference between rent expense recognized on the straight-line basis and cash paid is included in accrued expenses and other current liabilities on the accompanying consolidated balance sheets.

Minimum lease payments through the cancellation date of the respective leases are as follows at December 31:

2007	$ 330,500
2008	280,215
2009	137,037
	$ 747,752

Litigation

Since 2004, the Company and Nuance have been engaged with each other in litigation regarding various patent and trade secret matters. The Company does not believe this litigation and other various legal matters which have arisen in the ordinary course of business will be resolved in a manner that will have a material adverse effect on the financial condition, results of operations or cash flows of the Company. The Company believes these litigation matters are without merit and intends to defend these matters vigorously.

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2006, 2005 and 2004 (Continued)

9. Income Taxes

The benefit (provision) for income taxes for the Company for the years ended December 31, 2006, 2005 and 2004 is summarized as follows:

	2006	2005	2004
Current:			
Federal	$ (192,000)	$	$
State			
Foreign	(22,409)	(11,548)	
	(214,409)	(11,548)	
Deferred:			
Federal	342,000	2,739,000	
State	60,000	483,000	
Foreign			
	402,000	3,222,000	
	$ 187,591	$ 3,210,452	$

The effective combined domestic and foreign income tax rate of approximately 3%, (104)%, 0% in 2006, 2005, and 2004, respectively, differed from the federal statutory rate of 34% primarily because of changes in the valuation allowance and the alternative minimum tax liability recorded in 2006.

Temporary differences that give rise to significant deferred tax assets at December 31, 2006 and 2005 are as follows:

	2006	2005
Deferred tax assets:		
Net operating loss carryforwards	$ 5,150,000	$ 9,182,000
Deferred revenue	1,560,000	702,000
Tax credits	773,000	773,000
Other	251,000	48,000
	7,734,000	10,705,000
Deferred tax asset valuation allowance	(4,110,000)	(7,483,000)

	$ 3,624,000	$ 3,222,000

SFAS No. 109 requires a valuation allowance to be recorded if, based on the weight of the available evidence, it is more likely than not that some portion or all of the deferred tax asset may not be realized. During 2006 and 2005, the Company s valuation allowance decreased by approximately $3,373,000 and $2,020,000, respectively, based on its consideration of forecasted profitable operations.

At December 31, 2006, the Company had net operating loss carryforwards for federal and state income tax purposes of approximately $13,000,000, and research and development federal tax credit carryforwards of approximately $773,000 available to reduce federal and state taxable income. These carryforwards expire through 2025.

VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2006, 2005 and 2004 (Continued)

Under the provisions of the Internal Revenue Code, certain substantial changes in the Company s ownership may result in a limitation on the amount of net operating loss carryforwards, which can be used in future years.

10. Stockholders Deficit

At December 31, 2006, the Company is authorized to issue 128,000,000 and 80,084,844 shares of common stock and preferred stock, $.001 par value, respectively. The preferred stock consists of 5,600,000 shares designated as Series A Convertible Preferred Stock (Series A Preferred Stock), 1,820,000 shares designated as Series B Convertible Preferred Stock (Series B Preferred Stock), 6,383,294 shares designated as Series C Redeemable Convertible Preferred Stock (Series C Preferred Stock), and 66,281,550 shares designated as Series D Redeemable Convertible Preferred Stock (Series D Preferred Stock).

As of December 31, 2006, the Company has reserved for issuance the following shares of common stock for the exercise of stock options and the conversion of preferred stock:

Stock options	24,727,315
Convertible preferred stock	80,084,844
	104,812,159

11. Preferred Stock

Preferred Stock

The rights and preferences of the preferred stock are as follows:

Voting

The holders of all series of Preferred Stock shall vote together with all other classes and series of stock of the Company as a single class on all actions to be taken by the stockholders of the Company. Each share of Preferred Stock shall entitle the holder to such number of votes equal to the number of shares of Voting Common Stock (including fractions of a share) into which each share of Preferred Stock is then convertible.

Dividends

The holders of the Series C Preferred Stock and Series D Preferred Stock (Senior Preferred Stock) shall be entitled to receive cumulative dividends equal to $0.1053 per annum per share for Series C Preferred Stock and equal to $0.0182664 per annum per share for Series D Preferred Stock. The dividends will accrue daily in arrears whether or not such dividends are declared by the Board of Directors. At December 31, 2006, 2005 and 2004, cumulative unpaid dividends for Series C Preferred Stock totaled $4,439,944, $3,767,783 and $3,095,622, respectively, and cumulative unpaid dividends for Series D Preferred Stock totaled $4,503,807, $3,293,082 and $2,082,357 respectively.

The holders of the Series A Preferred Stock and Series B Preferred Stock (Junior Preferred Stock) shall be entitled to receive dividends, if and when, as declared by the Board of Directors, out of funds legally available for that purpose after the payment of all accrued and unpaid dividends to the holder of each share of Senior Preferred Stock.

VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2006, 2005 and 2004 (Continued)

Liquidation

In the event of any liquidation, dissolution or winding-up of the Company, the Series A, Series B, and Series C Preferred Stockholders shall receive a per share amount equal to the original issue price of the respective Series and dividends and the Series D Preferred Stockholders shall receive a per share amount equal to two times the Series D Preferred Stock original issue price, plus all declared and unpaid dividends.

Conversion

Each share of Preferred Stock, at the option of the holder, is convertible into fully paid and nonaccessable shares of voting common stock initially on a share-for-share basis. The Junior Preferred Stockholders are entitled to payment of any declared and unpaid dividends. The Senior Preferred Stockholders have the right to convert any accrued but unpaid dividends on the Senior Preferred Stock into the number shares of voting common stock based on a predetermined ratio, as defined in the Preferred Stock Agreement.

All series of Preferred Stock automatically converts to common stock upon the closing of an initial public offering at a share price not less than $2.50 per share and with net proceeds of at least $50,000,000.

Redemption

At any time on or after September 30, 2007, a Senior Majority Interest, as defined, may elect to have redeemed up to one-third of the originally issued and outstanding shares of Series C Preferred Stock and Series D Preferred Stock held by each holder at such time.

At any time on or after September 30, 2008, a Senior Majority Interest may elect to have redeemed up to that percentage of outstanding shares of Series C Preferred Stock and Series D Preferred Stock that would, when combined with any prior redemptions, result in the redemption by the Company of up to two-thirds of each of the originally issued and outstanding shares of Series C Preferred Stock and Series D Preferred Stock held by each holder of Senior Preferred Stock at such time.

At any time on or after September 30, 2009, a Senior Majority Interest may elect to have redeemed up to that percentage of outstanding shares of Series C Preferred Stock and Series D Preferred Stock that would, when combined with any prior redemptions, result in the redemption by the Company of up to one hundred percent (100%) of the originally issued and outstanding shares of Series C Preferred Stock and Series D Preferred Stock held by each holder thereof at such time.

The price for each share of Senior Preferred Stock redeemed shall be the greater of (i) an amount equal to the Series C Preferred Stock or Series D Preferred Stock Original Issue Price plus all accrued but unpaid dividends or (ii) the Fair Market Value of such shares of Senior Preferred Stock. The aggregate Redemption Prices shall be payable in cash in immediately available funds to the holders of the Senior Preferred Stock on the applicable redemption date.

The Series C and Series D Preferred Stock are not considered mandatorily redeemable as defined by SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*. Due to the fact that the redemption is in the control of the stockholders, the Series C and D Preferred Stock have been classified in the mezzanine section of the consolidated balance sheet.

12. Stock Option Plan

In 1998, the Company adopted the 1998 Stock Plan (the Plan) under which shares of the Company s common stock were reserved for issuance to employees, directors and consultants. Stock based awards granted under the Plan may be incentive stock options or nonstatutory stock options. Incentive stock options may only be granted to employees. Under the terms of the Plan, the Board of Directors shall specify the exercise price

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2006, 2005 and 2004 (Continued)

and vesting period of each stock option on the grant date, and certain options are exercisable upon the occurrence of a future event. The Plan authorizes the issuance of up to 24,727,315 shares of common stock. Typical vesting of the options is four years; 25% on the anniversary of the Effective Date and the remaining 75% of the shares at the rate of 1/12 per quarter over the next twelve quarters. The options generally expire at the earlier of ninety days from the end of employment or ten years from the date of grant.

At December 31, 2006, 2,932,368 shares were available for grant under the Plan. The following table summarizes the activity under the Plan:

	Number of Options		Weighted Average Exercise Price
Outstanding, December 31, 2003	16,332,100	$	0.12
Issued	3,566,958		0.09
Exercised	(537,439)		0.07
Forfeited	(737,659)		0.16
Outstanding, December 31, 2004	18,623,960	$	0.12
Issued	2,938,000		0.09
Exercised	(83,030)		0.09
Forfeited	(333,736)		0.09
Outstanding, December 31, 2005	21,145,194	$	0.11
Issued	770,000		0.10
Exercised	(657,975)		0.08
Forfeited	(1,231,066)		0.09
Outstanding, December 31, 2006	20,026,153	$	0.12
Options exercisable at December 31, 2006	16,810,847	$	0.12
Options exercisable at December 31, 2005	12,071,613	$	0.13
Options exercisable at December 31, 2004	7,857,354	$	0.15

The total intrinsic value of options exercised during the years ended December 31, 2006, 2005 and 2004 was $451,402, $0 and $10,050, respectively.

The following table summarizes information about stock options that are vested or expected to vest at December 31, 2006. The number of options outstanding is based on the unvested options outstanding at December 31, 2006, adjusted for the estimated forfeiture rate of 10%.

	Outstanding Options		
Exercise Prices	**Number Outstanding**	**Weighted-average Remaining Contractual Life**	**Weighted-average Exercise Price**
$ 0.04	1,590,000	3.04 years	$ 0.04
$ 0.09-$0.11	16,532,621	7.28 years	$ 0.09
$ 0.33	733,632	3.80 years	$ 0.33
$ 0.42-$0.45	1,169,900	4.77 years	$ 0.44

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2006, 2005 and 2004 (Continued)

Exercisable Options			
Exercise Prices	Number Outstanding	Weighted-average Remaining Contractual Life	Weighted-average Exercise Price
$ 0.04	1,590,000	3.04 years	$ 0.04
$ 0.09-$0.11	13,317,315	7.10 years	$ 0.09
$ 0.33	733,632	3.80 years	$ 0.33
$ 0.42-$0.45	1,169,900	4.77 years	$ 0.44

Cash received from option exercise under all share-based payment arrangements for the years ended December 31, 2006, 2005 and 2004 was $54,064, $7,473 and $38,320 respectively. No actual tax benefit was realized from option exercises during these periods. The aggregate intrinsic value of all options outstanding as of December 31, 2006 was $17,512,147. The aggregate intrinsic value of all exercisable options as of December 31, 2006 was $14,625,872.

Stock Options Issued for Services

The Company issues options to consultants to purchase shares of common stock. The shares vest over periods ranging up to four years. In accordance with SFAS No. 123(R) and EITF No. 96-18, *Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Connection with Selling Goods or Services*, the Company calculates compensation expense using the Black-Scholes option pricing model and is recording the expense over the vesting period. The compensation charge for the years ended December 31, 2006, 2005 and 2004 was $77,857, $17,342 and $48,155, respectively and is recorded in general and administrative expenses on the accompanying consolidated statements of operations.

13. 401(k) Savings Plan

The Company has established a defined contribution savings plan under Section 401(k) of the Internal Revenue Code. This plan covers substantially all employees who meet minimum age and service requirements and allows participants to defer a portion of their annual compensation on a pre-tax basis. Company contributions to the plan may be made at the discretion of the Board of Directors. To date there have been no contributions made to the plan by the Company.

14. Related Party

The Company has an investor who is a partner at the law firm that provides services as primary counsel for the Company. Legal fees incurred in connection with services provided by this law firm for the years ended December 31, 2006, 2005 and 2004 were approximately $78,000, $108,000 and $182,000, respectively.

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VOICE SIGNAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2006, 2005 and 2004 (Continued)

15. Foreign Operations

The Company operates and markets its services on a worldwide basis with its principal markets as follows:

	Years Ended December 31,		
	2006	**2005**	**2004**
Revenue by geographic region based on location of customer:			
North America	$ 12,096,745	$ 4,726,168	$ 1,266,874
Korea	12,488,439	6,787,337	6,159,183
Rest of world	16,244	227,421	40,723
Total revenue	$ 24,601,428	$ 11,740,926	$ 7,466,780

16. Subsequent Event

During 2007, the Company amended a contract with one of its major customers. The contract amendment extends the term of the contract through December 31, 2009 and provides for additional licenses, integration support, and additional languages for the respective products. The Company received a prepayment under the amendment and will recognize the related revenue over the term of the contract.

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Bluestar Resources Limited

Annual Financial Statements

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Report of Independent Auditors

The Board of Directors of
Bluestar Resources Limited

We have audited the accompanying consolidated balance sheets of Bluestar Resources Limited as of December 31, 2006 and 2005 and the related consolidated statements of income, shareholder s equity and cash flows for the years then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company s internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Bluestar Resources Limited at December 31, 2006 and 2005 and the consolidated results of its operations and its consolidated cash flows for the years then ended in conformity with United States generally accepted accounting principles.

/s/ S.R. BATLIBOI & ASSOCIATES

Mumbai, India
March 26, 2007

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Bluestar Resources Limited

Consolidated Balance Sheets

	December 31, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 365,845	$ 620,291
Accounts receivable, net	3,669,170	2,879,436
Amounts due from related parties	6,638,631	2,150,586
Employee receivables	12,619	147,433
Prepaid expenses	166,322	274,126
Deferred tax assets	58,267	41,203
Other current assets	125,092	2,320
Total current assets	11,035,946	6,115,395
Property and equipment, net	1,233,318	1,570,317
Rental and other deposits	427,859	316,686
Deferred tax assets	36,799	35,279
Investments in bank deposits		223,476
Total assets	$ 12,733,922	$ 8,261,153
LIABILITIES AND SHAREHOLDER S EQUITY		
Current liabilities:		
Accounts payable	$ 557,766	$ 401,203
Accrued employee costs	793,470	532,993
Obligations under capital leases current	134,097	117,542
Lines of credit	500,399	1,390,869
Long term debt current	192,183	179,406
Amounts due to related parties		112,855
Deferred tax liabilities	1,196,398	564,829
Income taxes payable	94,624	123,405
Other current liabilities	281,094	279,974
Total current liabilities	3,750,031	3,703,076
Long term debt non-current	197,047	238,841
Obligation under capital leases non-current	305,782	423,138
Commitments and contingencies		
Preference shares issued by a subsidiary	650,000	
Shareholder s equity		
Common stock, (par value $1 per share; 10,000 shares authorized; 10,000 shares issued and outstanding at December 31, 2006)	10,000	10,000
Additional paid-in-capital	780,107	780,107
Receivable from shareholder	(10,000)	(10,000)

Retained earnings	6,815,014	3,157,330
Accumulated other comprehensive income (loss)	235,941	(41,339)
Total Shareholder s equity	7,831,062	3,896,098
Total liabilities and shareholder s equity	$ 12,733,922	$ 8,261,153

See accompanying notes.

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Bluestar Resources Limited

Consolidated Statements of Income

	Years Ended December 31, 2006	2005
Revenue		
Third parties	$ 18,716,646	$ 12,328,480
Related parties	101,136	
	18,817,782	12,328,480
Cost of revenue	9,946,685	7,321,395
Gross profit	8,871,097	5,007,085
Selling, general and administrative expenses	3,704,263	2,562,228
Operating income	5,166,834	2,444,857
Interest expense	171,303	115,849
Other income (expense)	(585,202)	5,429
Income before income taxes	4,410,329	2,334,437
Provision for income taxes	726,212	331,864
Net income	$ 3,684,117	$ 2,002,573

See accompanying notes.

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Bluestar Resources Limited

Consolidated Statements of Shareholder s Equity
Years ended December 31, 2006 and 2005

	Common Stock Number	Common Stock Par Value	Additional Paid-In-Capital	Receivable From Shareholder	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholder s Equity
Balance at January 1, 2005	10,000	10,000	760,962	(10,000)	1,154,757	9,960	1,925,679
Issue of shares by Focus India			19,145				19,145
Comprehensive income:							
Net income					2,002,573		2,002,573
Foreign currency translation						(51,299)	(51,299)
Comprehensive income							1,951,274
Balances at December 31, 2005		10,000	780,107	(10,000)	3,157,330	(41,339)	3,896,098
Dividend on preference shares of subsidiary					(26,433)		(26,433)
Comprehensive income:							
Net income					3,684,117		3,684,117
Foreign currency translation						277,280	277,280
Comprehensive income							3,961,397
Balances at December 31, 2006	10,000	$ 10,000	$ 780,107	$ (10,000)	$ 6,815,014	$ 235,941	$ 7,831,062

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Bluestar Resources Limited

Consolidated Statements of Cash Flows

	Years Ended December 31, 2006	2005
Cash flow from operating activities		
Net income	$ 3,684,117	$ 2,002,573
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	658,119	557,976
Loss on sale of property and equipment	32,153	
Allowance for doubtful accounts	30,755	102,242
Preference shares of a subsidiary	650,000	
(Gain) loss on forward currency contracts	(109,229)	80,237
Deferred taxes	589,809	234,714
	5,535,724	2,977,742
Changes in operating assets and liabilities:		
Accounts receivables	(820,484)	(1,466,444)
Employee receivables	134,955	47,361
Prepaid expenses	116,671	(226,449)
Other current assets	(31,115)	3,115
Rental and other deposits	(101,100)	249,283
Accounts payable	112,447	2,575
Accrued employee costs	280,577	34,306
Income taxes payable	(26,726)	72,824
Other current liabilities	(669)	202,312
Net cash provided by operating activities	5,200,280	1,896,625
Cash flows from investing activities		
Proceeds from (Investments in) bank deposits	220,377	(229,019)
Purchase of property and equipment	(334,815)	(467,629)
Proceeds from sale of property and equipment	77,918	
Net cash provided by (used in) investing activities	(36,520)	(696,648)
Cash flows from financing activities		
Net change in amounts due from related parties	(4,472,146)	(1,607,587)
Repayment of debt	(38,183)	(122,351)
Net change in lines of credit	(895,216)	921,958
Principal payments under capital leases	(179,607)	(65,406)
Proceeds from issuance of equity shares by Focus India		19,145
Net cash provided by financing activities	(5,585,152)	(854,241)
Effect of exchange rate changes on cash and cash equivalents	166,946	(6,428)

Increase (decrease) in cash and cash equivalents		(254,446)		339,308
Cash and cash equivalents at the beginning of year		620,291		280,983
Cash and cash equivalents at the end of year	$	365,845	$	620,291
Supplemental disclosure of cash flow information:				
Assets acquired under capital leases	$	81,715	$	618,111
Cash paid for interest	$	171,303	$	115,871
Cash paid for income taxes	$	163,129	$	39,704

See accompanying notes.

Bluestar Resources Limited

Notes to the Consolidated Financial Statements
Years ended December 31, 2006 and 2005

1. Organization and Nature of Business

Focus Enterprises Limited, a Delaware corporation, doing business as Focus Infomatics, Inc. (Focus USA) is engaged in providing medical transcription services to customers in the United States. Focus USA outsources most of its activities to Focus Infosys India Private Limited, an Indian company, (Focus India). Focus USA and Focus India were wholly owned subsidiaries of Focus Enterprises Limited, a company incorporated in the British Virgin Islands (FEL).

In June 2006, the shares of Focus USA and Focus India were transferred to Bluestar Options Inc., a company incorporated in May 2006 in the British Virgin Islands. Bluestar Options, Inc. is a wholly owned subsidiary of Bluestar Resources Limited, a company incorporated in May 2006 in the British Virgin Islands. Bluestar Resources Limited (BSR) is wholly owned by Bethany Advisors, Inc., a company incorporated in the British Virgin Islands. Bethany Advisors, Inc. is owned by a trust organized in Liechtenstein. BSR and Bluestar Options, Inc. are holding companies.

2. Summary of Significant Accounting Policies

Basis of Preparation

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP).

The accompanying consolidated financial statements include the accounts of Bluestar Resources, Limited, its wholly-owned subsidiaries, Bluestar Options, Inc., Focus USA and Focus India (collectively, the Company). All significant inter company balances and transactions have been eliminated on consolidation.

BSR and FEL are entities under common control. Accordingly, the transfer of Focus USA and Focus India from FEL to Bluestar Options Inc. has been accounted for at historical cost in a manner similar to a pooling of interests. Accordingly, the historical financial periods prior to the incorporation of BSR include the financial information of Focus USA and Focus India, presented as if the transfer of shares had occurred at the beginning of the periods presented.

In August 2004, Focus India incorporated a wholly-owned subsidiary Focus Softek Limited, a company incorporated in India and research and development activity related to software that was being developed by Focus India was transferred to this subsidiary. In March 2006, the subsidiary was transferred to Focus Telecall, a subsidiary of FEL. Focus Telecall and Focus India are companies under common control and, accordingly, net assets and operations of Focus Softek have been excluded from the accompanying consolidated financial statements from the date of formation of Focus Softek.

Use of Estimates

The preparation of the financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Foreign Currency translation

The Company s reporting currency is the United States Dollar (US$).

The functional currency of Bluestar Resources Limited, Bluestar Options, Inc. and Focus USA is the US$. Focus India s functional currency is the Indian Rupee (Rs). For purposes of the consolidated financial statements, Focus India s assets and liabilities are translated into US$ at the exchange rate in effect at the balance sheet date, while revenue and expenses are translated at average exchange rates prevailing during the

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Bluestar Resources Limited

Notes to the Consolidated Financial Statements (Continued)

year. Translation adjustments are reported as a component of accumulated other comprehensive income (loss), a component of shareholder s equity.

Accumulated other comprehensive income (loss) comprises entirely the foreign currency translation adjustment.

Revenue

The Company derives revenue primarily from medical transcription services. Revenue from medical transcription services is recognized on the basis of agreed contractual unit rates per line transcribed or edited. Revenue is recognized when persuasive evidence of an arrangement exists, services have been rendered, the fee is determinable and collectibility is reasonably assured.

Cost of revenue

Cost of revenue primarily includes salaries and related costs, payments to contract employees, data link expenses, and depreciation and amortization on property and equipment used to provide medical transcription services.

Cash and cash equivalents

Cash and cash equivalents comprise cash at banks and in hand, and short-term deposits with an original maturity of three months or less.

Accounts receivable

Accounts receivable are stated net of an allowance for doubtful accounts. The allowance for doubtful accounts represents management s best estimate of receivables that are doubtful of recovery, based on historical write-off experience and ongoing evaluation of the customers credit worthiness.

The changes in the allowances for doubtful accounts for the years ended December 31, 2006 and 2005 were as follows:

	Year Ended December 31, 2006	Year Ended December 31, 2005
Balance at the beginning of the year	$ 102,242	$
Charged to operations	122,375	137,259
Write off, net of collections		(35,017)
Reversal	(91,620)	
Balance at the end of the year	$ 132,997	$ 102,242

Bluestar Resources Limited

Notes to the Consolidated Financial Statements (Continued)

Property and equipment

Property and equipment, including assets recorded under capital leases, are stated at cost. Depreciation and amortization includes the amortization charge relating to assets recorded under capital leases and is computed using the straight line method over the estimated useful life of the assets, which are as follows:

Assets Description	Asset Life (In Years)
Computers and software	3 5
Furniture and fixtures	7
Office equipment	3 7
Transcription equipment	1
Quality monitoring equipment	5 6
Vehicles	5

Property and equipment are reviewed for impairment if indicators of impairment arise. The evaluation of impairment is based upon a comparison of the carrying amount of the property and equipment to the estimated future undiscounted net cash flows expected to be generated by the property and equipment. If the estimated future undiscounted cash flows are less than the carrying amount of the property and equipment, the asset is considered impaired. The impairment expense is determined by comparing the estimated fair value of the property and equipment to its carrying value, with any shortfall from fair value recognized as an expense in the current period.

Derivative financial instruments

The Company s derivative financial instruments comprise forward currency contracts entered into by Focus India to manage its foreign currency exposures, arising from receivables from Focus USA.

The Company accounts for its derivative financial instruments in accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* , as amended. SFAS 133 requires the Company to recognize all derivatives at fair value. Although the Company believes that the derivatives are economic hedges, they do not meet the requirements under SFAS 133 for hedge accounting and, accordingly, recognizes the changes in fair value through earnings.

Changes in fair values of the Company s forward currency contracts resulted in a gain of $109,229 and loss of $80,237 during the years ended December 31, 2006 and 2005, respectively, which have been included in other income (expense) in the consolidated statements of income.

The fair values of the Company s forward currency contracts at December 31, 2006 and 2005 were $88,203 and $(23,424), respectively. The derivative asset is included in other current assets at December 31, 2006 and the liability is recorded in other current liabilities at December 31, 2005.

Income taxes

The Company applies the asset and liability method of accounting for income taxes as described in Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes* . Under this method, deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Bluestar Resources Limited

Notes to the Consolidated Financial Statements (Continued)

The Company evaluates potential exposures related to tax contingencies or claims made by the tax authorities in various jurisdictions and determines if a reserve is required.

Fair value of the financial instruments

The carrying amount reported in the balance sheets for cash and cash equivalents, accounts receivables, accounts payable and other current assets or current liabilities approximates their fair value due to short maturity of these items. The carrying value of the Company s debt also approximates its fair value.

Employee benefits

Defined contribution plan

Eligible employees of Focus India receive benefits from a Provident Fund, administered by the Government of India, which is a defined contribution plan. Both the employees and Focus India make monthly contributions to the Provident Fund equal to a specified percentage of the eligible employees salary. Focus India has no further obligation beyond the contributions made to the plan. Contributions are charged to income in the year in which they accrue and are included in the consolidated statements of income.

Defined benefit plan

Employees in India are entitled to benefits under the Payment of Gratuity Act, 1972, a defined benefit retirement plan covering eligible employees of Focus India. The plan provides for a lump-sum payment to eligible employees at retirement, death, and incapacitation or on termination of employment, of an amount based on the respective employee s salary and tenure of employment. The gratuity liability and net periodic gratuity cost have been actuarially determined after considering discount rates, and increases in compensation levels.

Concentration of credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, rental deposits, bank deposits and accounts receivable. Cash and cash equivalents and bank deposits are invested with financial institutions and banks having high investment grade credit ratings. Accounts receivable are unsecured and the Company monitors the credit worthiness of its customers to whom it grants credit terms in the normal course of its business and, generally, no collateral is required. Management believes there is no significant risk of loss in the event of non-performance of the counter parties to these financial instruments other than for amounts already provided for in the financial statements.

Recently issued accounting standards

In September 2006, the Financial Accounting Standard Board (FASB) issued SFAS No. 157, *Fair Value Measurements* . SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 provides guidance on the determination of fair value, and establishes a fair value hierarchy for assessing the sources of information used in fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15,

2007. The Company is currently evaluating the impact of this pronouncement on its financial statements.

In 2006, the FASB issued SFAS No. 158 *Employer s Accounting for Defined Benefit Pension and Other Postretirement Plans* , an amendment of SFAS Nos. 87, 88, 106, and 132(R). SFAS No. 158 requires a company to recognize, on the balance sheet, the funded status of pension and other postretirement benefit plans and recognize actuarial gains and losses, prior service cost, and any remaining transition amounts from

Bluestar Resources Limited

Notes to the Consolidated Financial Statements (Continued)

the initial application of SFAS Nos. 87 and 106 when recognizing a plan s funded status, with the offset to accumulated other comprehensive income. SFAS No 158 is applicable to the Company as of the end of the fiscal year ending after June 15, 2007 (March 31, 2008). SFAS No. 158 will also require fiscal-year-end measurements of plan assets and benefit obligations. The new Statement amends SFAS Nos. 87, 88, 106, and 132R, but retains most of their measurement and disclosure guidance and will not change the amounts recognized in the income statement as net periodic benefit cost. The Company believes that the adoption of SFAS No. 158 will not have a material impact on its financial statements.

In June 2006, the FASB issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes* , an interpretation of SFAS No. 109, to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold that a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company will adopt FIN 48 as of January 1, 2007, as required. The Company is currently evaluating the effect, if any, that the adoption of FIN 48 will have on the Company s financial position and results of operations.

3. Property and equipment, net

The major classes of property and equipment are as follows:

	December 31,	
	2006	**2005**
Computers and software	$ 2,413,135	$ 2,314,931
Furniture and fixtures	335,788	272,909
Office equipment	573,159	489,227
Transcription equipment	91,232	75,957
Quality monitoring equipment	55,823	54,489
Vehicles	235,395	229,528
	3,704,532	3,437,041
Less: Accumulated depreciation and amortization	(2,471,214)	(1,866,724)
Property and equipment, net	$ 1,233,318	$ 1,570,317

Depreciation and amortization expenses were $658,119 and $557,976, respectively, for the years ended December 31, 2006 and 2005, respectively.

Assets under capital leases as at December 31, 2006 and 2005 were $773,682 and $692,041, respectively, and the related accumulated amortization was $145,474 and $138,408, respectively.

4. Income taxes

Bluestar Resources Limited and its subsidiaries other than Focus USA and Focus India are incorporated in the British Virgin Islands and are not liable to income-tax. Focus USA and Focus India are liable for income taxes in the United States of America and India, respectively.

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Bluestar Resources Limited

Notes to the Consolidated Financial Statements (Continued)

Income (loss) before income taxes for the years ended December 31, 2006 and 2005 arose in the following jurisdictions:

	Year Ended December 31, 2006	Year Ended December 31, 2005
India	$ 4,772,178	$ 2,209,658
United States	337,533	124,779
British Virgin Islands	(699,382)	
	$ 4,410,329	$ 2,334,437

Income tax expense for the years ended December 31, 2006 and 2005 arising in the USA and India is as follows:

	Year Ended December 31, 2006	Year Ended December 31, 2005
India		
Current tax expense	$	$ 1,728
Deferred tax (benefit) expense	587,028	277,350
	587,028	279,078
United States		
Current tax expense	136,403	95,422
Deferred tax expense (benefit)	2,781	(42,636)
	139,184	52,786
	$ 726,212	$ 331,864

Focus India is eligible to claim income-tax exemption with respect to profits earned from export revenue from an operating unit registered under the Software Technology Parks of India (STPI). The benefit is available from the date of commencement of operations to March 31, 2009, subject to a maximum of 10 years. The deferred tax expense for India relates to temporary differences that are expected to reverse after the end of the tax holiday period. If the income tax exemption had not been available to Focus India, the tax expense at the Indian statutory rates would have been approximately $1.6 million.

Focus USA is liable for US federal and state income taxes.

Bluestar Resources Limited

Notes to the Consolidated Financial Statements (Continued)

The components of deferred tax assets and liabilities are as follows:

	December 31, 2006	December 31, 2005
Deferred tax assets		
Property and equipment	$ 36,799	$ 35,279
Allowance for doubtful accounts	58,267	41,203
Total deferred tax assets	$ 95,066	$ 76,482
Deferred tax liabilities		
Property and equipment	8,257	
Undistributed earnings of foreign subsidiaries	1,168,583	551,182
Other	19,558	13,647
Total deferred tax liabilities	$ 1,196,398	$ 564,829
Net deferred tax liabilities	$ 1,101,332	$ 488,347

The classification of deferred tax assets (liabilities) is as follows:

	December 31, 2006	December 31, 2005
Current		
Deferred tax assets	$ 58,267	$ 41,203
Deferred tax liabilities	(1,196,398)	(564,829)
Total	(1,138,131)	(523,626)
Non current		
Deferred tax assets	36,799	35,279
Total non current deferred tax assets	$ 36,799	$ 35,279

Focus USA and Focus India are two distinct tax entities that file income tax returns in separate tax jurisdictions, and, accordingly, deferred tax assets and liabilities of Focus USA and Focus India have not been netted.

5. Retirement benefits

Defined contribution plan

During the years ended December 31, 2006 and 2005 Focus India contributed $76,401 and $54,114, respectively, to the defined contribution plan.

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Bluestar Resources Limited

Notes to the Consolidated Financial Statements (Continued)

Defined benefit plan Gratuity

	Year Ended December 31, 2006	Year Ended December 31, 2005
Change in projected benefit obligations		
Obligations at beginning of the year	$ 34,331	$ 29,664
Service Cost	37,463	15,530
Interest cost	2,638	2,152
Benefits settled	(1,308)	(734)
Actuarial gain	(14,026)	(11,316)
Foreign currency translation	841	(965)
Benefit obligations/accrual at the end of the year	59,939	34,331
Net periodic gratuity cost		
Service cost	$ 37,463	$ 15,530
Interest cost	2,638	2,152
Actuarial gain	(14,026)	(11,316)
Net periodic gratuity cost	$ 26,075	$ 6,366

The assumptions used in accounting for the gratuity plan are set out as below:

	2006	2005
Discount factor	7.50%	7.50%
Rate of increase in the compensation levels	6.00%	6.00%

Focus India evaluates these assumptions annually based on its long-term plans of growth and industry standards. Currently, there is no requirement for funding of the gratuity plan in India and, accordingly, Focus India s gratuity plan is unfunded at December 31, 2006 and 2005. The accumulated benefit obligation amounted to $25,129 and $14,394 at December 31, 2006 and 2005, respectively. There is no unrecognized net actuarial loss at December 31, 2006 and 2005.

The expected benefit payments as of December 31, 2006 are as follows:

Year ending December 31,

2007	$ 1,647
2008	1,894
2009	2,178
2010	2,505
2011	2,881
2012-2016	12,770
	$ 23,875

6. Lines of credit

Focus India has a line of credit with a bank to borrow upto Rs. 10 million (approximately $227,000) that is secured by accounts receivable and certain other assets. The facility is repayable on demand, is renewable annually and bears interest of 10.75% per annum. The amount outstanding under this facility amounted to $200,399 and $191,077 at December 31, 2006 and 2005, respectively.

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Bluestar Resources Limited

Notes to the Consolidated Financial Statements (Continued)

In addition, Focus USA has a line of credit with a bank to borrow upto $1.5 million that is secured by all its assets and is guaranteed by a director of Focus USA. The facility is repayable on demand, is renewable annually and bears interest of 8.25% per annum. The amount outstanding under this facility amounted to $300,000 and $1,199,792 at December 31, 2006 and 2005, respectively.

7. Long-term debt

	December 31, 2006	December 31, 2005
Term loans(a)	$ 85,717	$ 204,701
Vehicle and equipment loans(b)	303,513	213,546
	389,230	418,247
Less: Current portion	192,183	179,406
	$ 197,047	$ 238,841

(a) Focus India has a term loan with a bank that is secured by Focus India s property and equipment other than for vehicles and certain other specified assets. The amounts outstanding under this loan amounted to $85,717 and $195,394 at December 31, 2006 and 2005, respectively. This loan bears interest at 12.25% per annum and is payable in quarterly installments of $28,332 through September 2007. Focus India had another term loan with this bank that was secured by its accounts receivable. This loan bore interest at 12.25% per annum and was repaid during the year ended December 31, 2006.

(b) Focus India has loans with different banks that were used to pay for the acquisition of vehicles and computer equipment. These loans bear interest at rates ranging from 6.47% per annum to 10.62% per annum and are secured by the equipment and vehicles. Amounts outstanding under these loan are payable in monthly installments through December 2010.

The maturity schedule of long term debt outstanding as of December 31, 2006 is set out as below:

Due in the Year Ending December 31,	Year
2007	$ 192,183
2008	107,570
2009	54,833
2010	24,953
2011	9,691

Total	$ 389,230

8. Shareholder s equity

The holder of each share of common stock of Bluestar Resources Limited is entitled to one vote per share.

9. Preference shares issued by a subsidiary

In June 2006, Bluestar Options, Inc., a wholly owned subsidiary of the Company, issued 650,000 preference shares. The preference shares were redeemable at their par value of $650,000 plus accrued dividends, at the option of the Company, prior to September 2007. The preference shareholder had the option to convert these shares into 650,000 ordinary shares of Bluestar Options, Inc.

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Bluestar Resources Limited

Notes to the Consolidated Financial Statements (Continued)

The preference shares were redeemed in January 2007. The Company recorded $650,000 as preference shares issued by a subsidiary (outside shareholder s equity) and as an expense included in other income (expense).

The preference shares carried a coupon of 8% per annum and the accrued amount through December 31, 2006 of $26,433 has been charged to shareholder s equity as a dividend on those preference shares and included in other current liabilities.

10. Related party transactions

Amounts due from related parties represent amounts due from

(a) FEL and subsidiaries of FEL for (i) advances made to them, (ii) amounts due in respect of expenses allocated to the subsidiaries of FEL and (iii) amounts due for expenses paid on behalf of the subsidiaries of FEL,

(b) A director of Focus USA and Focus India and

(c) Entities with whom a director of Focus USA and Focus India is associated.

Amounts due to related parties represent amounts payable to entities with whom a director of the Company is associated.

Interest is not payable or receivable on amounts due to and from related parties and all related party amounts are receivable/payable on demand.

Related party transactions are summarized below:

	Advances Made, Revenues, Expenses Allocated and Expenses Paid During the Year Ended December 31,		Receivable (Payable) at December 31	
	2006	2005	2006	2005
Amounts due from related parties				
FEL	(50,089)		$ 62,604	$ 112,693
Subsidiaries of FEL	4,781,817	825,851	6,304,418	1,623,737
Director	126,373	(57,436)	271,609	137,357
Entities associated with a Director	(276,799)	267,323		276,799
			$ 6,638,631	$ 2,150,586
Amounts due to related parties				

Entities associated with a Director	$	$ 112,855

In accordance with the provisions of an agreement the Company has with Focus Softek Limited, Focus Softek is required to provide free software maintenance to Focus India until March 2011.

11. Commitments and contingencies

Leases

Focus India and Focus USA have entered into capital leases principally for computers and vehicles and, operating leases for office premises and equipment. These capital leases give the Company the option to purchase these assets at a nominal value at the end of the lease period.

Bluestar Resources Limited

Notes to the Consolidated Financial Statements (Continued)

Future minimum lease payments under capital leases and non-cancelable operating leases consisted of the following at December 31, 2006:

Years Ending December 31,	Capital Leases	Operating Leases
2007	$ 169,511	$ 398,757
2008	156,730	315,519
2009	109,985	176,395
2010	56,886	106,665
2011		9,338
Total minimum lease payments	493,112	$ 1,006,674
Amounts representing interest	(53,233)	
Present value of minimum lease payments	$ 439,879	

Rent expense for the years ended December 31, 2006 and 2005 was $325,619 and $277,083, respectively.

Bank guarantees

Focus India s bankers have provided guarantees in favour of the Department of Excise and Customs of India. These guarantees are provided for availing the excise and custom duty exemption for importing capital goods into India and the amount of the bank guarantees furnished was $19,146 and $18,699 as of December 31, 2006 and December 31, 2005, respectively.

Taxes

Capital gains on transfer of shares of an Indian entity may attract capital gains or related taxes for the transferor. If the Indian tax authorities assess capital gains taxes and the transferor is unable to satisfy that liability, the Indian tax authorities may consider the Indian company liable for such taxes. However, the Company believes that the transfer of shares of Focus India from Focus Enterprises Limited to the Company is a demerger in the British Virgin Islands, and therefore exempt from capital gains taxes. Accordingly, no provision for such taxes has been made in the consolidated financial statements.

12. Subsequent events

In January 2007 and March 2007, Bluestar Resources Limited paid dividends of $5.78 million and $1.32 million, respectively, to its shareholder, Bethany Advisors, Inc.

In February 2007, the Finance Ministry of India proposed changes to tax rules, which if enacted, could levy a minimum alternative tax based on the revenues of Focus India. The Company has not evaluated the impact of this proposed rule, nor has it concluded whether the payment of such tax would be available as a credit beyond the tax holiday period of Focus India ending in 2009.

In March 2007, Bethany Advisors, Inc., the parent of the Company, entered into a Share Purchase Agreement with Nuance Communications, Inc., a company based in the United States, for Nuance Communications, Inc to acquire all of the shares of the Company. The agreement is subject to certain closing conditions.

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Dictaphone Corporation

Annual Financial Statements

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PRICEWATERHOUSECOOPERS LLP
300 Atlantic Street
Stamford CT 06901
Telephone (203) 539 3000
Facsimile (813) 207 3999

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of Dictaphone Corporation:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of cash flows, and of stockholders equity present fairly, in all material respects, the financial position of Dictaphone Corporation and it s subsidiaries at December 31, 2005 and 2004, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company s management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As is more fully described in Note 1, the Company announced on February 8, 2006 that it had signed a definitive agreement to be acquired by Nuance Communications, Inc.

(PRICEWATERHOUSECOOPERS LLP)

March 27, 2006

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors

DICTAPHONE CORPORATION

We have audited the accompanying consolidated statements of operations, changes in stockholders equity and cash flows of Dictaphone Corporation and its subsidiaries (the Company) for the year ended December 31, 2003. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the Auditing Standards Board of the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the results of Dictaphone Corporation s operations and its cash flows for the year ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3 Discontinued Operations, the consolidated financial statements for the year ended December 31, 2003 have been recast to reflect discontinued operations.

(GRANT THORNTON LLP)

New York, New York
March 10, 2004 (except with respect to the matters described in the
fourth paragraph above, as to which the date is March 24, 2006)

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DICTAPHONE CORPORATION

CONSOLIDATED BALANCE SHEETS

	December 31, 2005	December 31, 2004
	(Dollars in thousands except per-share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 19,165	$ 5,235
Short-term investments	991	
Accounts receivable, net of reserve for doubtful accounts of $5,343 and $6,474 respectively	37,510	34,987
Note receivable	2,600	
Inventories	7,598	9,523
Prepaid expenses and other current assets	4,256	2,404
Assets held for sale, current		44,757
Total current assets	72,120	96,906
Property, plant and equipment, net	13,867	15,666
Excess reorganization value and goodwill	64,815	65,308
Intangible assets, net	33,587	42,027
Other assets	2,957	2,488
Assets held for sale, noncurrent		35,547
TOTAL ASSETS	$ 187,346	$ 257,942
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 3,903	$ 3,901
Accrued liabilities	17,831	17,633
Current portion of deferred revenue	38,520	38,760
Customer deposits and other current liabilities	16,455	13,514
Current portion of long-term debt	46	109
Net liabilities held for sale, current		10,302
Total current liabilities	76,755	84,219
Deferred revenue	10,396	8,621
Pension, post retirement benefit obligations, and other liabilities	10,545	9,747
Long term debt	93	34,585
Net liabilities held for sale, noncurrent		16,730
Total liabilities	97,789	153,902
Commitments and contingencies		

Stockholders equity:				
Preferred stock (no par value, 5,000,000 shares authorized; no shares issued or outstanding as of December 31, 2005 and 2004)				
Common stock ($0.01 par value per share; 10,095,000 and 10,075,000 outstanding as of December 31, 2005 and 2004, respectively)		101		101
Additional paid-in-capital		122,149		121,926
Accumulated deficit		(31,517)		(18,937)
Cumulative comprehensive loss		(1,176)		950
Total stockholders equity		89,557		104,040
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	187,346	$	257,942

The accompanying notes are an integral part of these statements.

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DICTAPHONE CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Year Ended December 31,		
	2005	2004	2003
	(Dollars in thousands)		
REVENUES:			
Product sales	$ 70,456	$ 69,795	$ 65,027
Support and maintenance services	95,736	88,420	83,348
Other		272	
Total revenues	166,192	158,487	148,375
COSTS AND EXPENSES:			
Cost of product sales	48,359	42,459	40,406
Cost of support and maintenance services	35,860	35,206	37,782
Selling, general and administrative	65,825	68,711	75,081
Research and development	8,340	5,924	5,977
Severance and related expenses	2,497	3,820	1,540
Loss on sale of IVS international	3,146		
Costs related to the sale of Company	2,000		
Total costs and expenses	166,027	156,120	160,786
Income (loss) before interest, income taxes, and discontinued operations	165	2,367	(12,411)
Interest expense, net	(1,935)	(4,694)	(4,463)
Loss from continuing operations before reorganization items, and income taxes	(1,770)	(2,327)	(16,874)
Reorganization items, net		100	(567)
Loss from continuing operations before income taxes	(1,770)	(2,227)	(17,441)
Provision for income taxes	(183)	(542)	(469)
Loss from continuing operations	(1,953)	(2,769)	(17,910)
Discontinued operations:			
(Loss) income from discontinued operations	(4,175)	(13,422)	10,231
Loss on sale of discontinued operations	(6,452)		
Net loss	$ (12,580)	$ (16,191)	$ (7,679)

The accompanying notes are an integral part of these statements.

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DICTAPHONE CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Year Ended December 31,		
	2005	2004	2003
	(Dollars in thousands)		
OPERATING ACTIVITIES:			
Net loss	$ (12,580)	$ (16,191)	$ (7,679)
Less: net loss (income) from discontinued operations	10,627	13,422	(10,231)
Net loss from continuing operations	(1,953)	(2,769)	(17,910)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	18,228	17,072	15,426
Provision for doubtful accounts receivable	1,254	1,484	1,019
Write-off goodwill of IVS International	493		
Changes in assets and liabilities:			
Accounts receivable	(3,777)	(10,766)	2,439
Inventories	1,924	(2,104)	(752)
Prepaid expenses and other current assets	(1,852)	2,101	(1,944)
Accounts payable and accrued expenses	201	1,049	1,787
Deferred revenue	1,535	7,220	(708)
Other current liabilities	2,940	1,398	2,575
Other non-current liabilities	(2,062)	702	(2,008)
Other assets	(469)	1,667	(1,333)
Net cash provided by (used in) continuing operations	16,462	17,054	(1,409)
Net income (loss) from discontinued operations	(10,627)	(13,422)	10,231
Changes in net assets from discontinued operations	12,130	15,499	4,384
Net cash provided by (used in) discontinued operations	1,503	2,077	14,615
Net cash provided by operating activities	17,964	19,131	13,206
INVESTING ACTIVITIES:			
Continuing operations:			
Software development expenditures	(4,920)	(5,639)	(9,674)
Investment in fixed assets, net of disposals	(3,068)	(4,723)	(4,454)
Proceeds from sale of businesses	38,856		
Purchase of short-term investments	(991)		
Restricted cash		285	847
Net cash provided by (used in) continuing operations	29,877	(10,077)	(13,281)

Discontinued operations:			
Software development expenditures	(314)	(2,610)	(4,002)
Investment in fixed assets, net of disposals		(353)	(1,193)
Net cash used in discontinued operations	(314)	(2,963)	(5,195)
Net cash provided by (used in) investing activities	29,563	(13,040)	(18,476)
FINANCING ACTIVITIES:			
(Payments) borrowing of subordinated debt, GMAC Facilities Agreement and capital lease obligations	(34,555)	(2,975)	3,526
Common stock issued	223		750
Net cash (used in) provided by financing activities	(34,332)	(2,975)	4,276
Effect of exchange rate changes on cash	734	(311)	818
Change in cash	13,930	2,805	(176)
Cash and cash equivalents, beginning of period	5,235	2,431	2,607
Cash and cash equivalents, end of period	$ 19,165	$ 5,235	$ 2,431
Supplemental disclosure of cash flow information:			
Interest paid	$ 3,411	$ 2,393	$ 558
Income taxes paid	$ 181	$ 278	$ 660
Supplemental non-cash investing and financing activities:			
Property acquired under capital leases	$	$ 532	$
Non-cash issuance of common stock in-lieu of payment	$	$	$ 750
Note issued to buyer for EMS sale	$ 2,600	$	$
Additional minimum pension liability	$ 2,860	$	$

The accompanying notes are an integral part of these statements.

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DICTAPHONE CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY FOR THE YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005

	Common Stock	Additional Paid- In Capital	Accumulated Income (Deficit)	Accumulated Comprehensive Income (Loss)	Total Comprehensive Income (Loss)	Total Stockholders Equity
	(Dollars in thousands)					
BALANCE AT DECEMBER 31, 2002	$ 101	$ 121,176	$ 4,933	$ 444		$ 126,654
Net loss			(7,679)		$ (7,679)	(7,679)
Stock issuance in lieu of cash payment		750				750
Foreign currency translation adjustment				817	817	817
Comprehensive loss					$ (6,862)	
BALANCE AT DECEMBER 31, 2003	101	121,926	(2,746)	1,261		120,542
Net loss			(16,191)		$ (16,191)	(16,191)
Foreign currency translation adjustment				(311)	(311)	(311)
Comprehensive loss					$ (16,502)	
BALANCE AT DECEMBER 31, 2004	101	121,926	(18,937)	950		104,040
Net loss			(12,580)		$ (12,580)	(12,580)
Stock issuance		223				223
Minimum pension liability adjustment				(2,860)	(2,860)	(2,860)
Foreign currency translation adjustment				734	734	734
Comprehensive loss					$ (14,706)	
BALANCE AT DECEMBER 31, 2005	$ 101	$ 122,149	$ (31,517)	$ (1,176)		$ 89,557

The accompanying notes are an integral part of these statements.

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DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005, 2004 AND 2003

NOTE 1 NATURE OF OPERATIONS

Dictaphone Corporation (Dictaphone or the Company) is a leader in the development, marketing, service and support of highly scalable dictation and speech recognition systems which incorporate advanced speech recognition and natural language technology focused primarily upon the medical dictation and transcription markets.

Dictaphone is headquartered in Stratford, Connecticut, and has worldwide marketing, sales, service, and support organizations throughout the United States, United Kingdom, Canada and Europe. The Company has three business units: Healthcare Systems, Integrated Voice Systems, and International Operations. The Healthcare Systems and Integrated Voice Systems businesses consist of the sale and service of system-related products to dictation and voice management customers in selected vertical markets in North America. The International Operations business primarily serves the medical dictation and transcription markets for the rest of the world. Approximately 92%, 89% and 91% of the Company s revenue from continuing operations was generated from the United States market in 2005, 2004 and 2003, respectively. During 2005, the Company sold three of its former business units including the Communication Recording System business, Contract Manufacturing business and International Integrated Voice Systems business. (See Note 3 Discontinued Operations).

On February 8, 2006, the Company announced that it had signed a definitive agreement with Nuance Communications, Inc. (Nuance) whereby Nuance will acquire 100% of the common stock of Dictaphone. Under the terms of the agreement, consideration for the transaction is $357 million in cash, subject to adjustments.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The financial statements have been prepared and presented in accordance with the American Institute of Certified Public Accountants Statement of Position 90-7, Financial Reporting by Entities in Reorganization under the Bankruptcy Code (SOP 90-7), and in conformity with accounting principles generally accepted in the United States of America. As discussed in Note 4, the Company completed its reorganization under Chapter 11 of the United States Bankruptcy Code when the Plan was confirmed on March 13, 2002 by the Bankruptcy Court and became effective on March 28, 2002. For financial reporting purposes, the Company used an effective emergence date of March 31, 2002. References to the Predecessor Company refer to the Company on or prior to March 31, 2002, while references to the Successor Company refer to the Company after March 31, 2002, after giving effect to the issuance of new securities in exchange for previously outstanding obligations in accordance with the Plan and implementation of fresh-start accounting in accordance with SOP 90-7. The securities issued pursuant to the Plan and fresh-start adjustments are described in Note 4, Reorganization in 2002.

SOP 90-7 does not change the application of accounting principles generally accepted in the United States of America. However, it does require that the financial statements for periods including and subsequent to filing the Chapter 11 petition distinguish transactions and events that are directly associated with the reorganization from the ongoing operations of the business.

Consolidation

The consolidated financial statements include the Company and all majority-owned subsidiaries as follows: Dictaphone Canada Ltd, DSP Inc., iChart Corporation, Dictaphone International Ltd. (99.99% owned), Dictaphone Deutschland GmbH, Dictaphone NV, and Dictaphone International A.G. All intercompany accounts and transactions have been eliminated.

DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. The estimates and assumptions used in the accompanying consolidated financial statements are based upon management s evaluation of the relevant facts and circumstances as of the date of the financial statements. Actual results could differ from those estimates. The most significant estimates relate to the allowance for doubtful accounts, the reserve for sales returns, the valuation of inventory at the lower of cost or market, and estimates of fair value for purposes of revenue recognition in multiple element arrangements.

Cash and cash equivalents

Cash equivalents include short-term, highly liquid investments with maturities of three months or less from the original date of purchase. Cash in foreign countries totaled approximately $0.9 million and $1.1 million as of December 31, 2005 and 2004, respectively.

Short-term investments

All investments with original maturities greater than three months and less than twelve months are considered short-term investments. The Company considers its short-term investments to be available for sale securities as defined in Statement of Financial Accounting Standards No. 115 Accounting for Certain Investments in Debt and Equity Securities (SFAS 115). Such securities are carried at fair value with the unrealized gains/ losses recorded as other comprehensive income. These investments are not subject to significant market risk.

Fair value of financial instruments

The recorded values of cash, accounts receivable, accounts payable and accrued liabilities reflected in the financial statements approximate their fair values due to the short-term nature of the instruments. Borrowings under the subordinated notes are deemed to be at market rates and thus the liabilities reflected in the financial statements approximate their fair values.

Inventory valuation

Inventories are valued at the lower of cost (first-in, first-out basis) or market. The Company provides for estimated obsolescence or unmarketable inventory in an amount equal to the difference between the cost of the inventory and the estimated market value based upon assumptions about future demand and market conditions.

Research and development expenses

All costs incurred to establish the technological feasibility of software products or product enhancements are expensed as incurred. Research and development expenses were $8.3 million, $5.9 million, and $6.0 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Computer software development costs

The Company records at cost purchased software and also capitalizes certain software development costs in accordance with the provisions of Statement of Financial Accounting Standards No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed (SFAS 86). Such amounts are included in intangible assets on the consolidated balance sheets (see Note 10). In accordance with SFAS 86, software development costs are capitalized once a product reaches technological feasibility and until such time

DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

as the product is released for sale. Such amounts totaled \$4.9 million, \$5.6 million, and \$9.7 million for the years ended December 31, 2005, 2004, and 2003, respectively. Capitalized software development costs are amortized ratably over their expected useful life of approximately 36 months. Amortization expense from continuing operations was \$6.2 million, \$3.8 million, and \$1.5 million for the years ended December 31, 2005, 2004 and 2003, respectively. Amortization expense of capitalized software development costs is included in cost of product sales in the consolidated statements of operations for all periods presented.

Property, plant and equipment and depreciation

Property, plant and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the various assets ranging from three to twelve years for machinery and equipment, three years for software, both internally developed and purchased, over the remaining life of the lease for leasehold improvements, and up to 35 years for buildings. The Company capitalizes software costs for internal use in accordance with the provisions of SOP 98-1 Accounting for computer software developed or obtained for internal use. Major improvements which add to productive capacity or extend the life of an asset are capitalized while repairs and maintenance are charged to expense as incurred. Other depreciable assets are depreciated using the straight-line method over the related estimated useful lives. As part of its reorganization and implementation of fresh-start accounting in accordance with SOP 90-7, the Successor Company adjusted the historical cost of property, plant, and equipment to its fair value on March 31, 2002, and reset the accumulated depreciation and amortization balance to zero on that date.

Intangible assets

All intangible assets acquired that are obtained through contractual or legal right, or are capable of being separately sold, transferred, licensed, rented or exchanged are recognized as assets apart from goodwill. Goodwill and intangibles with indefinite lives are not subject to amortization and are subject to at least an annual assessment for impairment by applying a fair-value based test.

In connection with the fair-value valuation of intangibles and fresh-start reporting, the Company reflected intangibles for patents and technology, which are being amortized over three to four years, and intangibles for customer service relationships that are being amortized over seven years. Values ascribed to trade names, trademarks and excess reorganization value having indefinite lives are not being amortized but are reviewed annually as of December 31 for impairment (see Notes 9 and 10). The Company reviews the carrying value of its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

Recoverability of long-lived assets is assessed by a comparison of the carrying amount of the asset to the estimated future net cash flows expected to be generated by the asset or the market-value approach. As a result of such review, it was determined that the future cash flows from the Company s Communications Recording Systems (CRS) business, which had been adversely affected by continued competitive market conditions throughout 2004, no longer supported the carrying value of the CRS assets. Accordingly, in 2004, the Company recorded an impairment in the value of this business of \$15.3 million. Such impairment charge has been included in the loss from discontinued operations (see Note 3 Discontinued Operations).

Other assets

Other assets consist of prepaid pension assets of $2.2 million and $2.1 million as of December 31, 2005 and 2004, respectively, reflecting amounts contributed in excess of expense, and other assets of $0.8 million and $0.4 million as of December 31, 2005 and 2004, respectively.

DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Impairment of long-lived assets

For the years ending December 31, 2005, 2004 and 2003, the Company evaluated its long-lived assets for impairment whenever events or changes in circumstances indicated that the carrying amount of such assets or intangibles might not be recoverable. Recoverability of assets to be held and used was measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. As a result of this analysis, no such impairments were recorded for the years ending December 31, 2005, 2004 or 2003.

Revenue

Revenue is recognized when earned. For products with a significant software element (primarily speech recognition, and voice processing), the Company records revenue attributable to the hardware and software elements upon installation and acceptance from the customer and defers revenue attributable to undelivered elements, including training and maintenance, to the periods in which the related obligations are performed. Vendor-specific objective evidence exists for each of these undelivered elements, derived from the sale prices of each element of the sales arrangement when sold separately. Revenue for all other products (primarily analog desktop, portable dictation products and electronic manufactured components that do not have significant software content) is recognized upon shipment or when service is performed. Revenue from maintenance, support and dictation services is recognized ratably over the relevant contractual period. The Company may grant sales discounts to customers. Such sales discounts are reflected as a reduction in the revenue from product sales or services when sold separately. All amounts billed to a customer in a sales transaction related to shipping and handling represent revenues earned for the goods provided and are included as revenue. Shipping and handling fees from continuing operations included in revenue were $0.2 million for the years ended December 31, 2005 and 2004, and $0.3 million for 2003.

Maintenance contracts

Maintenance contracts (support services) are generally billed in advance; the related revenue is included in deferred revenue and amortized ratably into income as earned over the term of the contract.

Allowance for doubtful accounts

Accounts receivable are stated at amounts due from customers net of allowances for doubtful accounts. Accounts outstanding longer than the contractual payment terms are considered past due. The Company s estimate for the allowance for doubtful accounts is based on a two step process. First, the Company evaluates specific accounts where it has information that the customer may have the inability to meet its obligations (bankruptcy, etc.) or the obligation is in dispute (litigation, etc.). In these cases the Company uses its judgment based upon available facts and circumstances and records a specific reserve. Second, an unallocated reserve is established for all customers based on several factors, including historical write-offs as a percentage of sales. When a receivable balance is known to be uncollectible, such receivable is written-off.

Reserve for cancellations and returns

The Company provides a reserve for maintenance contracts expected to be cancelled for non-payment and returns for product sales. All cancellations and returns are recorded as a reduction of revenue to the extent earned or as a reduction of deferred revenue. The Company estimates the amount of maintenance contracts to be cancelled for non-payment and expected product returns based on historical experience and known cancellations or returns. As of December 31, 2005 and 2004, the Company had $4.8 million and $7.1 million, respectively, recorded for such cancellations and returns which is reflected in accrued liabilities on the consolidated balance sheets.

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DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Product Warranties

The Company offers customary and extended product warranties to its customers. The Company defers an element of product revenues for these warranties when products are sold and records revenues on warranties on a straight-line basis over the term of the related warranty. Service costs are expensed as incurred. Deferred revenues related to warranties were $0.9 million and $1.2 million as of December 31, 2005 and 2004, respectively.

Changes in the Company s product warranty liability are as follows (in thousands):

	Year Ended December 31, 2005	Year Ended December 31, 2004
Balance, beginning of period	$ 1,207	$ 1,050
Warranty revenue deferred	3,695	3,971
Warranty revenue recognized	(3,995)	(3,814)
Balance, end of period	$ 907	$ 1,207

Costs and expenses

Cost of product and operating expenses of service field and technical support, which represent the cost of support services revenue, are included in cost of product sales or cost of support and maintenance services, as applicable, when incurred.

Advertising expenses

The Company expenses all advertising costs as incurred and classifies these costs under selling, general and administrative expenses. Advertising costs from continuing operations were $2.9 million, $2.1 million and $1.7 million for each of the years ended December 31, 2005, 2004 and 2003, respectively.

Income taxes

The company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS 109). Accordingly, deferred tax assets and liabilities are recognized for operating loss and tax credit carryforwards and for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not that such assets will be realized.

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DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock based compensation

The Company has stock-based compensation plans for employees and directors which are described more fully in Note 16. The Company has elected to apply the intrinsic-value method of accounting for stock-based compensation. Employee options vest 28.6% at the date of grant and 23.8% on the anniversary date of the grant date for the next three years. Directors options vest 25.0% at the date of grant and 25.0% on the anniversary date of the grant date for the next three years. All options expire after five years from the date of grant. The following table illustrates the pro-forma effect on net loss as if the Company had applied the fair-value recognition provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock Based Compensation (SFAS 123), using the minimum-value method for the years ended December 31, 2005, 2004, and 2003 (in thousands):

	Year Ended December 31, 2005	Year Ended December 31, 2004	Year Ended December 31, 2003
Net loss as reported	$ (12,580)	$ (16,191)	$ (7,679)
Stock based compensation expense	(277)	(482)	(532)
Pro forma net loss	$ (12,857)	$ (16,673)	$ (8,211)

The fair value of these stock options was estimated using the minimum-value method as defined and prescribed by SFAS 123 for nonpublic entities based upon a risk-free interest rate of 5% and an expected life of 5 years.

In December 2004, the FASB issued SFAS No. 123R (revised 2004), Share-Based Payment (SFAS 123R), which replaces SFAS No. 123, Accounting for Stock-Based Compensation and supercedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values, beginning with the first interim or annual period after December 15, 2005 for non-public entities. The Company is evaluating the requirements of the pronouncement and expects that the adoption of SFAS 123R will have an effect on its results of operations. The Company is currently reviewing the method of adoption, valuation methods and support for the assumptions that underlie the valuation of the awards. The adoption of SFAS 123R may be material to the Company s operating results or financial position.

Translation of foreign currencies

Assets and liabilities of foreign subsidiaries are translated at the rate of exchange in effect on the balance sheet date, while income and expenses are translated at the average rates of exchange prevailing during the period. The resulting translation adjustment is reflected in the cumulative comprehensive income within stockholders equity on the consolidated balance sheet, and the change in the cumulative translation adjustment is reflected as a separate component of consolidated comprehensive income (loss). Foreign currency gains and losses resulting from transactions are included in the results of operations.

Reclassifications

Certain amounts in the statements have been reclassified to conform to the current year presentation.

Recent accounting pronouncements

Inventory costs

In November 2004, FASB issued SFAS No. 151, Inventory Costs An Amendment of ARB No. 43, Chapter 4 (SFAS No. 151). SFAS No. 151 requires that items such as idle facility expense, excessive

DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

spoilage, double freight and rehandling costs be excluded from the cost of inventory and expensed as incurred. Additionally, SFAS No. 151 requires that the allocation of fixed overheads be based on the normal capacity of the production facilities. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. The Company is currently evaluating the effect that the adoption of SFAS No. 151 will have on the consolidated results of operations and financial position.

Stock-based compensation

In December 2004, FASB issued SFAS No. 123R Share-Based Payment (SFAS No. 123R), which revised SFAS No. 123 and supersedes APB No. 25. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options to be recognized in the financial statements based on their fair values. The pro forma disclosures previously permitted under SFAS No. 123 will no longer be an alternative to financial statement recognition. SFAS No. 123R is effective at the beginning of the first interim or annual period beginning after June 15, 2005. In April 2005, the United States Securities and Exchange Commission [SEC] announced the adoption of a new rule that amends the compliance dates for SFAS No. 123R. The SEC s new rule allows companies to implement SFAS No. 123R at the beginning of their next fiscal year, instead of the next reporting period that begins after June 15, 2005. Accordingly, the Company is required to adopt SFAS No. 123R beginning January 1, 2006. The Company is currently evaluating the effect that the adoption of SFAS No. 123R will have on the consolidated results of operations and financial position.

NOTE 3 DISCONTINUED OPERATIONS

As a result of a decline in the performance of the Company s CRS business unit and the Company s decision to focus more on its Healthcare business during 2005, the Company committed to a plan to sell its CRS business unit. Effective May 31, 2005, the Company sold the CRS business to NICE Systems, Inc. for approximately $38.5 million. The Purchase and Sale Agreement provided for a purchase price adjustment based upon the net asset value as defined in the agreement. As a result of such adjustments and settlements of the indemnification provisions of the original agreement, the Company has agreed to a $2.0 million reduction in purchase price. Such settlement will be satisfied through the final release of the $3.0 million of funds held in escrow of which the Company will receive $1.0 million in 2006. This receivable is included in prepaid and other current assets.

Additionally, effective December 30, 2005, the Company sold its EMS business to Bulova Technologies EMS LLC (Bulova) for approximately $5.0 million in cash and a $2.6 million note receivable due January 30, 2006. The Company currently is in negotiations to extend the due date of such note. The principal balance of the note was approximately $1.6 million as of February 28, 2006. The note is secured by the receivables of the EMS business. The Company also entered into a Supply Agreement that sets the pricing structure with Bulova through June 2007. Such Supply Agreement does not require any minimum purchase amount nor is the product sourced through Dictaphone for a significant element of its existing business. Therefore, the Company has determined that this does not constitute significant on-going involvement, and, accordingly, the company has reflected this disposition as a discontinued operations in the accompanying consolidated statements of operations. In a separate transaction, the Company sold 18 acres adjacent to the EMS manufacturing facility in Melbourne, Florida for approximately $2.6 million in cash ($2.4 million net of closing costs).

The Company also completed the sale of its international IVS business during the third quarter of 2005. The sale was not presented as part of discontinued operations as the Company has significant ongoing involvement with the new owner of the international IVS business to deliver certain products. In addition to recording product revenues related to the sale of certain products, the Company also receives royalties for all

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DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

international IVS sales and records such royalties as product revenues. As part of the sale the Company retained a 15% ownership in the business.

The results of CRS and EMS through their dates of sale have been presented as discontinued operations for the years ended December 31, 2005, 2004 and 2003. Certain operating information with respect to discontinued operations for the years ended December 31, 2005, 2004 and 2003 are summarized as follows (in thousands):

	December 31, 2005	December 31, 2004	December 31, 2003
Revenues:			
Product sales	$ 47,657	$ 58,521	$ 57,487
Support and maintenance services	12,985	34,557	34,648
Other revenue		1,000	9,000
Total revenues	60,642	94,078	101,135
Cost and expenses:			
Cost of sales	51,318	62,619	60,012
Selling, general and administrative	7,720	21,388	22,704
Research and development	2,439	3,948	4,251
Severance and related expenses	1,101	458	841
Impairment of intangibles		15,250	
Amortization of intangibles	2,239	3,837	3,096
Total cost and expenses	64,817	107,500	90,904
Operating (loss) income from discontinued operations	$ (4,175)	$ (13,422)	$ 10,231

Dictaphone s CRS Division was a leader in the design, development, manufacture and service of digital loggers. Digital loggers record information in a digital format, using computer hard drives and digital audiotape (DAT), enabling simultaneous recording of a number of channels per unit, and immediate random access retrieval. On September 19, 2000, Dictaphone filed a complaint (the Dictaphone Complaint) in the United States District Court for the District of Connecticut against Nice Systems Ltd. and Nice Systems, Inc. (collectively NICE). NICE was a competitor of Dictaphone s Communications Recording Systems business unit in the digital logger market where it sold loggers to financial institutions, customer contact-centers and public-safety markets. The Dictaphone Complaint alleged, among other things, that NICE s digital logger products infringe on various Dictaphone digital logger patents.

On December 11, 2003, the Company reached a settlement with NICE regarding the Company s patent infringement suit against NICE. As part of the settlement, the Company and NICE agreed to dismiss all claims and counterclaims against each other and grant each other a worldwide, royalty-free, perpetual license to certain of their respective patents including the disputed patents. Additionally, Dictaphone was to receive payments totaling $10.0 million in several installments, of which $8.0 million was received within 30 days of the settlement date ($5.0 million was received in December 2003 and $3.0 million was received in January 2004). The remaining $2.0 million was received in six quarterly installments of $333 thousand commencing in March 2004, with the final payment due in June 2005. Of the $2.0 million to be paid over such time, $1.0 million was subject to Dictaphone s performance of certain obligations. Accordingly, in December 2003, the Company recognized $9.0 million of this settlement, representing $8.0 million due within 30 days of signing this agreement plus $1.0 million future payments not subject to future performance obligations. In March and December 2004, the Company satisfied the performance obligations of the settlement agreement

DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and the Company recorded an additional $1.0 million. Such revenues are included as Other revenue in the table above.

Summarized balance sheet information with respect to discontinued operations as of December 31, 2004 is as follows (in thousands):

Assets held for sale:	
Accounts receivable, net	$ 20,601
Inventories	20,974
Prepaid and other current assets	3,239
Property, plant and equipment, net	6,404
Excess reorganization value	12,846
Intangibles, net	16,240
Total assets held for sale	80,304
Liabilities held for sale:	
Accounts payable	3,115
Accrued expenses and provisions	4,141
Deferred revenue	16,539
Other current and non-current liabilities	3,237
Total liabilities held for sale	27,032
Net assets held for sale	$ 53,272

Summarized below are the details supporting the loss on sale from discontinued operations as of December 31, 2005 (in thousands):

Proceeds from sale, net	$ 41,456
Assets sold:	
Accounts receivable, net	14,584
Inventories	16,724
Prepaid and other current assets	1,730
Property, plant and equipment, net	5,863
Intangibles, net	29,604
Total assets sold	68,505
Liabilities sold:	
Accounts payable	1,491
Accrued expenses and provisions	1,661

Deferred revenue	15,530
Other liabilities	1,915
Total liabilities sold	20,597
Net assets sold	47,908
Loss on sale of discontinued operations	$ (6,452)

The majority of the EMS and CRS assets were pledged as collateral for the GMAC Facilities Agreement (see Note 12). These assets were released from any pledges at the time of their respective sales.

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DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 4 REORGANIZATION IN 2002

Dictaphone was acquired by Lernout & Hauspie Speech Products N.V. (L&H NV), a Belgian-based speech and language company, in May 2000. In November 2000, L&H NV and certain of its United States subsidiaries, including Dictaphone (the L&H Group), filed voluntary petitions for relief under Chapter 11 of title 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. The Predecessor Company was guarantor of certain debt of L&H NV.

On January 31, 2002, the Predecessor Company filed the Third Amended Plan of Reorganization of Dictaphone Corporation under Chapter 11 of the Bankruptcy Code (the Plan). The Plan sets forth how claims against and equity interests in the Predecessor Company were to be treated following emergence from Chapter 11. On March 13, 2002, the Bankruptcy Court confirmed the Plan, which became effective on March 28, 2002. Dictaphone s reorganization affected a substantial de- leveraging of the balance sheet of Dictaphone through the conversion of a substantial portion of Dictaphone s pre-petition indebtedness into equity. Under the Plan, all previously issued common stock was cancelled and the Successor Company issued 10,075,000 shares of newly created common stock, warrants to purchase an additional 1,625,000 shares of common stock and $27.3 million of subordinated 12% five-year notes.

On April 7, 2004, a Final Decree was entered in the Court thereby closing out the Company s Chapter 11 proceedings.

The Company s emergence from Chapter 11 bankruptcy proceedings on March 28, 2002 resulted in a new reporting entity and adoption of fresh-start reporting in accordance with SOP 90-7. The estimated reorganization value (equity plus interest-bearing debt less available cash) of the Successor Company of $150.0 million, which served as the basis for the Plan approved by the creditors and the Bankruptcy Court, was used to determine the equity value allocated to the assets and liabilities of the Successor Company as follows (in thousands):

Reorganization value	$ 150,000
Less: Subordinated notes	(27,250)
GMAC facilities agreement	(3,612)
Capital lease obligations	(884)
Add: Cash	3,023
Equity value	$ 121,277

The Successor Company incurred reorganization expenses of $0.6 million for the year ended December 31, 2003 and settled certain reorganization items in 2004 for $0.1 million less than what was previously accrued for.

NOTE 5 SEVERANCE AND RELATED EXPENSES

As part of the Company s strategy to focus on its healthcare business, the Company divested its CRS Division and EMS manufacturing business in the second and fourth quarters of 2005. As part of these divestitures, the Company recorded severance and related expenses totaling $3.6 million. Severance and related expense of $1.1 million was incurred due to the sale of its CRS division and charged to discontinued operations. The remaining $2.5 million related to terminations primarily associated with the realignment of the service organization was charged to continuing operations.

In May 2004, the Company announced the restructuring of certain functions and the abandonment of specific product offerings to further reduce the Company s operating expenses. As a result, the Company recorded a charge of approximately $4.3 million in asset write-offs and severance expense associated with these actions. Severance expense for discontinued operations was approximately $0.5 million. The remaining

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DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

severance expense of $1.5 million, along with the $2.3 million of assets write-off were charged to continuing operations.

In 2003, the Company incurred $2.4 million of severance expense, including related benefits costs, for the elimination of 112 positions, mainly in service, in connection with a worldwide reorganization to better align the Company s resources. Severance expense for discontinued operations was approximately $0.9 million and the remainder of $1.5 million was incurred in continuing operations.

The following summarizes severance and related expenses incurred for the years ended December 31, 2005, 2004 and 2003 (in thousands):

	2005	2004	2003
Abandonment of product offerings	$	$ 2,282	$
Severance and other obligations	3,598	1,996	2,381
Total severance and related expense	3,598	4,278	2,381
Less: Severance from discontinued operations	(1,101)	(458)	(841)
Total severance and related expense from continuing operations	$ 2,497	$ 3,820	$ 1,540

The following is a summary of severance and other obligations reserve activity incurred during the years ended December 31, 2005 and 2004 (in thousands):

	2005	2004
Beginning balance January 1	$ 169	$ 2,110
Incurred	3,598	1,996
Cash payments	(3,563)	(3,937)
Ending balance December 31	$ 204	$ 169

As of December 31, 2005 and 2004, the Company had $0.3 million and $0.2 million, respectively, of such severance and related costs remaining to be paid which are classified in accrued liabilities on the consolidated balance sheets.

NOTE 6 ACCOUNTS RECEIVABLE

Accounts receivable consist of the following (in thousands):

	December 31, 2005	December 31, 2004
Trade receivable	$ 42,853	$ 41,461
Less allowance for doubtful accounts	(5,343)	(6,474)
Accounts receivable, net	$ 37,510	$ 34,987

The majority of the Company s receivables were pledged as collateral for the GMAC Facilities Agreement (see Note 12).

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DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Changes in the Company s allowance for doubtful accounts for the years ended December 31, 2005 and 2004 were as follows (in thousands):

	Year Ended December 31, 2005	Year Ended December 31, 2004
Balance at beginning of period	$ 6,474	$ 4,990
Provisions for bad debts	1,254	1,484
Accounts written off	(2,385)	
Balance at end of period	$ 5,343	$ 6,474

NOTE 7 INVENTORIES

Inventories consisted of the following (in thousands):

	December 31, 2005	December 31, 2004
Supplies and service parts	$ 4,104	$ 4,923
Inventory at customers	2,820	3,036
Finished products	674	1,564
Inventories	$ 7,598	$ 9,523

The majority of the Company s inventories were pledged as collateral for the GMAC Facilities Agreement (see Note 12).

NOTE 8 PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment, net consist of the following (in thousands):

	December 31, 2005	December 31, 2004
Land and land improvements	$ 506	$ 615
Buildings	4,585	4,585

Leasehold improvements		611		589
Machinery and equipment		20,404		20,835
Computer software		12,732		11,812
Equipment under capital leases		510		510
Subtotal		39,348		38,946
Accumulated depreciation		(25,481)		(23,280)
Property, plant and equipment, net	$	13,867	$	15,666

Depreciation expense from continuing operations was $4.9 million, $6.1 million and $6.7 million, respectively, for the years ended December 31, 2005, 2004 and 2003.

The majority of the Company s property, plant and equipment was pledged as collateral for the GMAC Facilities Agreement (see Note 12).

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DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9 EXCESS REORGANIZATION VALUE AND GOODWILL

The Company attributes all of the excess reorganization value and goodwill acquired to the software element of the business. The following summarizes excess reorganization value and goodwill for the years ended December 31, 2005 and 2004 (in thousands):

	December 31, 2005	December 31, 2004
Excess reorganization value	$ 65,308	$ 65,308
Write-off of IVS international goodwill	(493)	
Total	$ 64,815	$ 65,308

The Company performs an annual assessment in December for impairment of intangible assets by applying a fair-value based test. Impairment was measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the respective business unit. As a result of such review, as of December 31, 2004, it was determined that the future cash flows from the Company s CRS business, which had been adversely affected by continued competitive market conditions throughout 2004 and continued declines in revenue and margins, no longer supported the carrying value of the CRS assets. Accordingly, in December 2004, the Company recorded an impairment in the value of this business of $15.3 million which has been reflected in the net loss from discontinued operations. In 2005, the Company completed the sale of its IVS international business and as a result wrote-off the remaining goodwill of $0.5 million (See Note 3).

NOTE 10 INTANGIBLE ASSETS

The following summarizes intangible assets, net of accumulated amortization (in thousands):

	December 31, 2005	December 31, 2004
Indefinite-lived intangible assets		
Trade name and trademarks	$ 6,780	$ 6,780
Other intangible assets		
Patents and technology	36,910	32,026
Customer service relationships	28,406	28,406
Subtotal	65,316	60,432

Total gross intangible assets		72,096		67,212
Accumulated amortization				
Patents and technology		(23,291)		(14,025)
Customer service relationships		(15,218)		(11,160)
Total accumulated amortization		(38,509)		(25,185)
Intangible assets, net	$	33,587	$	42,027

Estimated annual amortization expense of intangible assets is approximately $11.3 million, $8.1 million, $5.8 million, and $1.0 million for the years ended December 31, 2006, 2007, 2008, and 2009, respectively. No amortization expense has been estimated for future projects where the cost has not been incurred as of December 31, 2005. Amortization expense of $13.4 million, $11.0 million, and $8.7 million has been included as cost of product sales for the years ended December 31, 2005, 2004, and 2003, respectively.

DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 ACCRUED LIABILITIES

Accrued liabilities consist of the following (in thousands):

	December 31, 2005	December 31, 2004
Sales returns reserve	$ 4,800	$ 7,137
Sales incentives and bonuses	5,871	2,662
Other	7,160	7,834
Total accrued liabilities	$ 17,831	$ 17,633

NOTE 12 DEBT

Debt is comprised of the following (in thousands):

	December 31, 2005	December 31, 2004
Subordinated notes	$	$ 34,446
Capital lease obligations	139	248
Total long-term debt	139	34,694
Less current portion	(46)	(109)
Long-term portion	$ 93	$ 34,585

On March 28, 2002, the Successor Company entered into a three-year revolving-credit facilities agreement with GMAC Commercial Finance LLC (GMAC Facilities Agreement) providing for borrowings of up to $30.0 million subject to certain availability limitations as stipulated in the agreement. The Company deferred $0.8 million in 2002 and $0.3 million in 2001 of fees and expenses associated with the GMAC Facilities Agreement, which were classified as other assets on the consolidated balance sheets and were amortized to interest expense over the three-year term of the agreement. Borrowings under this facility bear interest at a variable rate of either: prime rate plus 2.00% or Libor plus 3.25% as elected periodically by the Company, and a fee of 0.5% for the unused portion of the available credit line is charged to the Company monthly and classified in interest expense on the consolidated statements of operations. Under the terms of the agreement, the Company is required to maintain certain minimum earnings levels and financial ratios and is prohibited from paying dividends. If the Company fails to meet any of its requirements, GMAC may, at its option, accelerate the payment of any amounts outstanding. Cash receipts are applied from the

Company s lockbox accounts directly against the bank line of credit. Primarily all of the Company s assets are pledged as collateral for this obligation. The GMAC Facilities Agreement was scheduled to expire under its terms on March 28, 2005. On March 2, 2005, the Company and GMAC extended the GMAC Facilities Agreement through February 2007 under similar terms and conditions. The Company incurred a $0.3 million fee in connection with the extension of the Facilities Agreement. As of December 31, 2005, the Company had a net availability of $8.5 million under the GMAC Facilities Agreement.

Upon emergence from bankruptcy, the Company issued $27.3 million of 12.0% Subordinated Notes (the Notes) due March 28, 2007 to a former group of creditors who held claims in the bankruptcy. Interest at a rate of 12.0% per annum was payable semiannually on April 1 and October 1 in each year, commencing October 1, 2002. Under the terms of the Notes, the Company elected to pay interest in Like-Kind Notes for all periods through April 1, 2004. The Notes provided that the Company could prepay all or any portion of the principal amount of the Notes without penalty. In June and September 2005, the Company prepaid all of the Notes.

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DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Payments due on capital lease obligations during each of the four years subsequent to December 31, 2005 are as follows (in thousands):

Years Ending December 31,	
2006	$ 46
2007	27
2008	33
2009	33
Total capital lease obligations	$ 139

NOTE 13 INCOME TAXES

The provision for income taxes for the years ended December 31, 2005, 2004 and 2003 consists of the following (in thousands):

	Year Ended December 31, 2005	Year Ended December 31, 2004	Year Ended December 31, 2003
Current provision:			
Federal	$	$	$
State			
Foreign	183	542	469
Subtotal	183	542	469
Deferred provision (benefit)			
Federal	(3,453)	6,921	(10,556)
State	(822)	1,646	(2,512)
Foreign			
Subtotal	(4,275)	8,567	(13,068)
Valuation allowance	4,275	(8,567)	13,068
Provision for income taxes	$ 183	$ 542	$ 469

A reconciliation of income tax expense computed at the United States Federal statutory rate of 35% and the Company s effective tax rate for the years ended December 31, 2005, 2004 and 2003 are as follows:

	Year Ended December 31, 2005	**Year Ended December 31, 2004**	**Year Ended December 31, 2003**
Federal income tax expense, at statutory rate	(35.0)%	(35.0)%	(35.0)%
Foreign operations	1.5	3.5	6.5
Other	1.2	1.1	0.3
Increase in valuation allowance	33.8	(0.2)	34.7
Impairment of intangibles		34.1	
Effective tax rate	1.5%	3.5%	6.5%

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DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The components of the deferred tax assets and liabilities as of December 31, 2005 and December 31, 2004 were as follows (in thousands):

	December 31, 2005	December 31, 2004
Deferred tax assets:		
Net operating loss carryforwards	$ 79,849	$ 65,181
Amortization of intangibles	10,732	14,711
Advanced billings	6,847	9,371
Allowance for doubtful accounts	2,137	6,222
Inventory	1,870	963
Tax credit carryover	6,581	6,081
Other	2,399	3,741
Total deferred tax assets	110,415	106,270
Deferred tax liabilities:		
Depreciation	(1,691)	(1,806)
Other	(308)	(323)
Total deferred tax liabilities	(1,999)	(2,129)
Valuation allowance	(108,416)	(104,141)
Net deferred tax assets	$	$

Deferred income taxes are recognized for temporary differences between financial statement and income tax bases of assets and liabilities and net operating loss carryforwards for which income tax expenses or benefits are expected to be realized in future years. The valuation allowance was established since, in the opinion of management, it is more likely than not that all, or some portion, of net deferred tax assets will not be realized.

Upon emergence from bankruptcy, the Predecessor Company realized cancellation of indebtedness income (CODI), for financial reporting purposes, of approximately $460.2 million, which is the amount the indebtedness discharged that was exceeded by any consideration given in exchange thereof. The Internal Revenue Code provides that a debtor emerging from bankruptcy must reduce certain of its tax attributes, such as net operating loss carryforwards, by certain types of CODI actually realized.

The Company s United States net operating loss carryforwards at December 31, 2005, after reduction of applicable CODI, are approximately $193.4 million, and foreign net operating loss carryforwards are $16.6 million. These carryforwards, if not utilized, will begin expiring in 2011 through 2025.

In addition, as a result of the emergence from bankruptcy and the implementation of the Plan in 2002, the Company experienced an ownership change pursuant to and as defined by Internal Revenue Code Section 382 (IRC 382). As a result, approximately $62.0 million of the Company s United States net operating loss carryforwards will be subject to the limitations imposed by IRC 382. Under IRC 382, if a corporation undergoes an ownership change, the amount of its pre- ownership change losses that may be utilized to offset future taxable income is, in general, subject to an annual limitation, which the Company estimates to be approximately $6.0 million per year.

NOTE 14 COMMON STOCK

On the effective date of the Company s emergence from bankruptcy in accordance with the Plan (see Note 4), all Predecessor Common Stock was cancelled and 20,000,000 shares of newly created common stock, par value $0.01 per share, (Successor Common Stock) was authorized and the Company issued

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DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10,075,000 shares of Successor Common Stock to creditors in settlement of their claims. In addition, warrants to purchase an additional 1,625,000 shares of Successor Common Stock were issued to certain creditors (see Note 4 and 15). In 2005, 20,000 options were exercised by a former director under the terms of the Outside Director s Stock Option Plan (see Note 16). As of December 31, 2005, the Company has reserved 2,805,000 shares of Successor Common Stock for warrants and stock option grants.

An additional 5,000,000 shares of preferred stock, no par value, were authorized in accordance with the Plan.

NOTE 15 WARRANTS

In connection with the Company s emergence from bankruptcy (see Note 4), the Company issued Successor Common Stock and new four-year warrants to purchase an aggregate of 1,625,000 shares of Successor Common Stock in exchange for the discharge of bondholder debt. The value of the Successor Common Stock and warrants are reflected in additional paid-in capital in the consolidated balance sheets. Subject to the occurrence of a Triggering Event , the warrants may be exercised at a strike price of $20.00 per share through March 28, 2006.

Triggering Events are either a sale of all or substantially all of the Company or its assets, or if no such sale occurs, then the warrants may be exercised during the sixty (60) day period prior to the termination date. No warrants have been exercised to date.

NOTE 16 STOCK OPTION PLANS

Employee Stock Option Plan

Effective March 28, 2002, the Board of Directors adopted the 2002 Stock Option Plan (the Employees Plan). The Employees Plan authorizes the Compensation Committee to administer the Employees Plan and to grant eligible employees of the Company non-qualified Incentive Stock Options within the meaning of section 422 of the Internal Revenue Code of 1986. No more than 1,000,000 shares of Successor Common Stock may be issued upon exercise of options granted under the Employees Plan, and the maximum number of options that may be awarded to a participant under the Employees Plan is options for 200,000 shares per year subject to stock splits, stock dividends, recapitalizations and similar events. The term of each option shall not be more than 10 years from the date of grant. The exercise price of the options granted under the Employees Plan cannot be less than the fair market value of the Successor Common Stock on the date of grant. Options may be granted under the Employees Plan until March 27, 2007. For the year ended December 31, 2003, the Company issued 56,000 stock options, under the Employees Plan with a five-year term and a three-year vesting schedule at an exercise price of $14.50 per share. There were no stock options granted in 2004. In 2005, the Company granted 157,000 options under the Employees Plan with a five-year term and a three-year vesting schedule at an exercise price of $14.00 per share.

Outside Directors Stock Option Plan

Effective March 28, 2002, the Board of Directors adopted the 2002 Outside Directors Stock Option Plan (the Directors Plan). The Directors Plan authorizes the Compensation Committee to administer the Directors Plan and to grant to non-employee outside directors of the Company non-qualified Incentive Stock Options within the meaning of section 422 of the Internal Revenue Code of 1986. No more than 200,000 shares of Successor Common Stock may be issued upon exercise of options granted under the Directors Plan, and the maximum number of options that may be awarded to a participant under the Directors Plan is options for 20,000 shares per year subject to stock splits, stock dividends recapitalizations and similar events. The term of each option shall not be more than 10 years from the date of grant. The exercise price of the options granted under the Directors Plan cannot be less than the fair market value of the Successor Common Stock on the date of grant. Options may be granted under the Directors Plan until March 27, 2007. For the year ended

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DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2003, the Company issued 20,000 stock options, under the 2002 Directors Stock Option Plan with a five-year term and a three-year vesting schedule at an exercise price of $14.50 per share. There were no stock options granted in 2004 and 2005. In 2005, a former director exercised 20,000 stock options with an exercise price of $11.15 per share for $0.2 million.

Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123) establishes financial accounting and reporting standards for stock-based employee compensation plans. SFAS 123 establishes a fair-value based method of accounting for employee stock options, which provides for compensation cost to be charged to results of operations over the vesting term. SFAS 123 also allows companies to continue to follow the intrinsic value method of accounting for employee stock options as prescribed by Accounting Principles Board Opinion 25, Accounting for Stock issued to Employees (APB 25). APB 25 generally requires compensation cost to be recognized only for the excess of the fair value of the stock at the date of grant over the price that the employee must pay to acquire the stock (the intrinsic value method). The Company has elected to account for its stock-based compensation in accordance with the intrinsic value method and therefore has not recognized compensation expense for stock options issued to its employees and directors, since the exercise price of those awards was equal to the fair-market value of the stock on the date of grant.

Stock option activity for the Employees Plan and Directors Plan from the initial date of grant on March 28, 2002 through the year ended December 31, 2005 is as follows:

	Employees Plan		**Directors Plan**		**Total**	
	Options Outstanding	**Per Share**	**Options Outstanding**	**Per Share**	**Options Outstanding**	**Per Share**
Balance outstanding December 31, 2002	678,250	$ 11.15	100,000	$ 11.15	778,250	$ 11.15
Options granted March 2003	56,000	$ 14.50	20,000	$ 14.50	76,000	$ 14.50
Options cancelled	(18,750)	$ 11.86		$	(18,750)	$ 11.86
Balance outstanding December 31, 2003	715,500	$ 11.32	120,000	$ 11.71	835,500	$ 11.37
Options cancelled	(21,000)	$ 13.49		$	(21,000)	$ 13.49
Balance outstanding December 31, 2004	694,500	$ 11.26	120,000	$ 11.71	814,500	$ 11.32
Options granted February 2005	157,000	$ 14.00			157,000	$ 14.00
Options cancelled	(147,250)	$ 11.61			(147,250)	$ 11.61
Options exercised			(20,000)	$ 11.15	(20,000)	$ 11.15
Balance outstanding						

December 31, 2005	704,250	$ 11.86	100,000	$ 11.82	804,250	$ 11.86
Weighted average remaining life	2.777 years		2.505 years		2.774 years	
Exercise price range	$ 11.15 - $14.50		$ 11.15 - $14.50		$ 11.15 - $14.50	

As of December 31, 2005 and 2004, the Company had 295,750 and 305,500 stock options available for grant under the Employees Plan, respectively, and 80,000 stock options available for grant under the Directors Plan. As of December 31, 2005 and 2004, respectively, the Company had 684,891 and 520,165 options exercisable under both the Employees Plan and the Directors Plan.

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DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 17 COMMITMENTS, CONTINGENCIES AND CONCENTRATIONS OF RISK

Commitments

The Company leases certain factory equipment and office facilities under lease agreements extending from one to ten years. In addition to factory equipment and office facilities leased, the Company leases computer and information processing equipment under lease agreements extending from three to five years. Future minimum lease payments for non-cancelable operating leases as of December 31, 2005 are as follows (in thousands):

Years Ending December 31,	
2006	$ 1,763
2007	423
2008	210
2009	113
Total minimum lease payments	$ 2,509

Rental expense under operating leases was $2.4 million, $3.8 million, and $3.9 million for the years ended December 31, 2005, 2004, and 2003, respectively.

Contingencies

From time to time, the Company may be involved in litigation relating to claims arising out of its ordinary course of business. The Company believes that there are no claims or actions pending or threatened against the Company, the ultimate disposition of which would have a material impact on the Company s financial position or results of operations, nor does the Company believe that the ultimate resolution of the litigation, administrative proceedings and environmental matters mentioned below in the aggregate will have a material adverse effect on the Company s consolidated financial position or results of operations.

On April 20, 2004, a complaint was filed (under seal) in the Southern District of New York alleging default by the Company of certain contractual obligations owed to a licensor and purporting to terminate the agreement between the parties. In addition to vigorously defending such a claim, the Company affirmatively asserted certain counter-claims against such licensor for default of its contractual obligation to the Company. On February 8, 2005, the Company and the licensor entered into an agreement settling both the breach of contract claims the licensor had brought against the Company and the Company s counterclaims against the licensor. Under the terms of the settlement, the Company gains the right to incorporate new technology offered by the licensor into a broader range of the Company s products, and agrees over a period of 3-to-5 years to phase out its use of the current technology supplied by the same licensor. Also under the settlement, the Company agrees, beginning in the second half of 2006, to pay higher royalty rates and maintenance fees. In February 2005, the Company made advance payments of professional service fees, royalties, and software maintenance fees totaling approximately $1.0 million.

The Company is subject to federal, state and local laws and regulations concerning the environment and is currently participating in one group of potentially responsible parties in connection with third-party disposal sites. The annual operation and management for such sites has been minimal and the settlement predates the Company s separation from Pitney Bowes, a former owner of the Company. Consequently, management believes that its future liability, if any, for these sites is not material. In addition, regardless of the outcome of such matters, Pitney Bowes has agreed to indemnify the Company in connection with retained environmental liabilities and for breaches of the environmental representations and warranties in the Stock and Asset Purchase Agreement, originally executed on April 25, 1995 and amended August 11, 1995 between Dictaphone Acquisition Corporation and Pitney Bowes, subject to certain limitations.

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DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 18 PENSION AND OTHER POST-RETIREMENT BENEFITS

Defined Contribution Plan

The Company sponsors a defined contribution plan (401(k) Plan) for United States employees. In 2003, the Company matched 50% of employee contributions up to 6% of eligible compensation, subject to certain limitations. Total Company contributions were $1.0 million for the year ended December 31, 2003. In 2004, the Company modified its matched contributions to 50% of employee contributions up to 4% of eligible compensation. Total Company contributions were $0.8 million for the years ended December 31, 2005 and 2004.

Defined Benefit Plans

The Company sponsors defined benefits plans providing certain retirement and death benefits for qualifying employees in the United Kingdom and Canada. The plans assets are invested by an independent trustee and are invested primarily in equity and fixed income securities. As of December 31, 2005, 60% of the plans assets were invested in equity securities and 40% of the plans assets were invested in fixed income securities. The overall expected long term rate of return is based upon historical returns and future expectations. For the 2006, we have adopted a risk premium of 2.9% above yields available on 15 year government bonds. Since the plan invest in bonds we have chosen a slightly lover expected return on plan assets of 6.1%. As a result of the sale of the CRS division and the IVS International business, the Company recorded a curtailment gain of $0.7 million. This gain has been recorded in SG&A expense. The following table sets forth the amounts recognized in the Company s consolidated balance sheets and plan assets as of December 31, 2005 and December 31, 2004 for Company sponsored defined benefit pension plans (in thousands):

	Pension Benefits	
	Year Ended December 31, 2005	Year Ended December 31, 2004
Reconciliation of projected benefit obligation		
Projected benefit obligation at beginning of period	$ 21,838	$ 18,969
Service cost	375	386
Interest cost	1,072	1,054
Benefits paid	(1,097)	(1,098)
Actuarial loss	3,544	790
Settlement	(403)	
Curtailment gain	(709)	
Employee contributions	86	114
Translation adjustment	(2,025)	1,623
Projected benefit obligation at end of period	$ 22,681	$ 21,838

Reconciliation of assets		
Assets at beginning of period	$ 16,951	$ 14,818
Actual return on plan assets	2,335	1,334
Settlement	(403)	
Employer contributions	367	537
Employee contributions	86	114
Benefits paid	(1,097)	(1,098)
Translation adjustment	(1,183)	1,246
Fair value of plan assets at end of period	$ 17,056	$ 16,951

DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table sets forth the reconciliation of funded status, net periodic benefit cost and discount rate assumptions for Company sponsored defined benefits pensions plans (in thousands):

	Year Ended December 31, 2005	Year Ended December 31, 2004	Year Ended December 31, 2003
Reconciliation of funded status			
Funded status	$ (5,625)	$ (4,886)	$ (4,151)
Unrecognized actuarial loss	3,668	1,738	1,127
Net amount recognized at end of period	$ (1,957)	$ (3,148)	$ (3,024)
Net periodic benefit cost components			
Service cost	$ 375	$ 386	$ 310
Interest on projected benefit obligation	1,072	1,054	906
Expected return on assets	(1,062)	(1,065)	(861)
Curtailment gain	(709)		
Settlement gain	56		
Net actuarial gain recognition	36	26	44
Net periodic benefit cost	$ (232)	$ 401	$ 399
Discount rate for net periodic benefit cost	4.80%-5.75 %	5.50%-6.00 %	5.50%-6.00 %
Salary increase assumption	3.50%-3.80 %	3.50%-3.75 %	3.50%-3.75 %
Long-term rate of return on assets	6.10%-7.50 %	7.00%-7.50 %	7.00%-7.50 %
Measurement date	12/31/2005	12/31/2004	12/31/2003

The discount rate used was based on long bond yields as at the measurement date in accordance with FAS 87. The assumptions are in accordance with accepted actuarial practice. The Company expects to make annual pension benefit payments of approximately $1.7 million for each of the years ended December 31, 2006, 2007, 2008, 2009 and 2010, respectively, and $5.4 million, in total, for the five-years ended December 31, 2011 through 2015.

At December 31, 2005, the Company s accumulated benefit obligation for pensions exceeded its recorded net pension liability. As a result, the Company recorded an additional minimum pension liability of $2.9 million. This liability, and the related offset to accumulated other comprehensive income, are reflected in our balance sheet at December 31, 2005.

Post-Retirement Benefit Plan

The Company provides certain post-retirement health care and life insurance benefits, which consist of a fixed subsidy for qualifying employees in the United States and Canada. Substantially all of these employees may become eligible for coverage. Most retirees outside the United States and Canada are covered by government sponsored and administered programs. As a result of the sale of the CRS division and EMS business, the Company recorded a curtailment gain of $1.4 million. This gain has been recorded in selling, general, and administrative expense.

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DICTAPHONE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table sets forth the amounts recognized in the Company s consolidated balance sheets and plan assets as of December 31, 2005 and 2004 for Company sponsored post-retirement benefit plans (in thousands):

	Postretirement Benefits December 31, 2005	Postretirement Benefits December 31, 2004
Reconciliation of projected benefit obligation		
Projected benefit obligation at beginning of period	$ 4,404	$ 4,077
Service cost	366	355
Interest cost	230	237
Plan amendments	(1,867)	
Curtailment gain	(1,437)	
Benefits paid	(128)	(265)
Actuarial gain	(259)	
Projected benefit obligation at end of period	$ 1,309	$ 4,404
Reconciliation of assets		
Assets at beginning of year	$	$
Employer contributions	128	265
Benefits paid	(128)	(265)
Fair value of plan assets at end of period	$	$

The following table sets forth the reconciliation of funded status, net periodic benefit cost and certain assumptions for Company sponsored postretirement benefit plans (in thousands):

	Year Ended December 31, 2005	Year Ended December 31, 2004	Year Ended December 31, 2003
Reconciliation of funded status Funded status	$ (1,309)	$ (4,404)	$ (4,077)
Unrecognized prior service cost	(1,867)		
Unrecognized actuarial gain	(361)	(146)	(145)
Net amount recognized at year end	$ (3,537)	$ (4,550)	$ (4,222)
Net periodic benefit cost components:			
Service cost	$ 366	$ 355	$ 303

Interest on projected benefit obligation	230	237	232
Recognized actuarial gain	(44)		(15)
Net periodic benefit cost	$ 553	$ 592	$ 520
Discount rate for net periodic benefit cost	5.40%	6.00%	6.00%
Salary increase assumption	N/A	N/A	N/A
Long-term rate of return on assets	N/A	N/A	N/A

The discount rate used was based on the interest rate on high quality fixed income rates whose cash flows match the timing and amount of expected benefit payments. The Company expects to make annual postretirement benefit payments of $0.1 million in each of the five years ended December 31, 2006 through 2010 and $0.7 million, in total, for the five years ended December 31, 2011 through 2015. The Company funds its post retirement and life insurance benefits on a pay-as-you-go or cash basis and therefore does not invest its assets with an independent trustee.

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Former Nuance Communications, Inc.

Interim Financial Statements

FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2005	December 31, 2004
	(In thousands, except share and per share amounts) (Unaudited)	
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 71,585	$ 53,583
Short-term investments	15,076	37,493
Accounts receivable, net of allowance for doubtful accounts of $377 and $583, respectively	6,830	13,953
Prepaid expenses and other current assets	4,568	3,839
Total current assets	98,059	108,868
Equipment, net	3,848	4,059
Long-term note receivable		5,005
Intangible assets, net	374	580
Restricted cash	11,398	11,109
Deferred income taxes	390	398
Other assets	221	238
TOTAL ASSETS	$ 114,290	$ 130,257
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 1,382	$ 1,328
Accrued liabilities	6,902	8,067
Merger expenses payable	2,301	
Restructuring reserve	10,322	10,203
Current deferred revenue	5,904	8,157
Total current liabilities	26,811	27,755
Long-term deferred revenue	457	544
Long-term restructuring reserve	47,774	52,705
Other long-term liabilities	38	37
Total liabilities	75,080	81,041
Commitments and contingencies (Note 11)		
Stockholders equity:		
Common stock $0.001 par value; 250,000,000 shares authorized; 36,696,833 and 36,077,623 shares issued and outstanding, respectively	37	36

Additional paid-in capital	333,892	332,521
Accumulated other comprehensive income	875	1,035
Accumulated deficit	(295,594)	(284,376)
Total stockholders equity	39,210	49,216
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 114,290	$ 130,257

The accompanying notes are an integral part of these financial statements.

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30, 2005	Three Months Ended June 30, 2004	Six Months Ended June 30, 2005	Six Months Ended June 30, 2004
	(In thousands, except per share amounts) (Unaudited)			
REVENUE:				
License	$ 4,541	$ 7,169	$ 8,704	$ 12,672
Service	2,605	3,412	6,239	6,974
Maintenance	4,111	3,812	8,115	7,449
Total revenue	11,257	14,393	23,058	27,095
COST OF REVENUE:				
License	107	140	195	228
Service	3,263	2,254	6,381	4,851
Maintenance	619	683	1,271	1,391
Total cost of revenue	3,989	3,077	7,847	6,470
Gross profit	7,268	11,316	15,211	20,625
OPERATING EXPENSES:				
Sales and marketing	6,796	7,331	13,738	13,520
Research and development	3,006	3,562	6,198	7,732
General and administrative	2,264	2,345	5,415	4,274
Merger expenses	2,602		2,602	
Restructuring credits	(47)		(98)	(41)
Total operating expenses	14,621	13,238	27,855	25,485
Loss from operations	(7,353)	(1,922)	(12,644)	(4,860)
Interest and other income, net	623	306	1,210	540
Loss before income tax benefit	(6,730)	(1,616)	(11,434)	(4,320)
Income tax benefit	(63)	(20)	(216)	(117)
Net loss	$ (6,667)	$ (1,596)	$ (11,218)	$ (4,203)
Basic and diluted net loss per share	$ (0.18)	$ (0.05)	$ (0.31)	$ (0.12)
Shares used to compute basic and diluted net loss per share	36,435	35,386	36,278	35,226

The accompanying notes are an integral part of these financial statements.

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended June 30, 2005	Six Months Ended June 30, 2004
	(In thousands)	(Unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (11,218)	$ (4,203)
Adjustments to reconcile net loss to net cash used for operating activities:		
Depreciation and amortization	1,491	1,523
Loss on asset disposals	103	
Non-cash stock-based compensation		73
Reduction in the allowance for doubtful accounts	(206)	(225)
Deferred income taxes	8	
Changes in operating assets and liabilities:		
Accounts receivable	7,328	2,793
Prepaid expenses, other current assets and other assets	(708)	25
Accounts payable	(282)	321
Accrued liabilities, and other current and long-term liabilities	(1,164)	574
Merger expenses payable	2,301	
Restructuring reserve	(4,812)	(3,971)
Deferred revenue	(2,341)	(1,388)
Net cash used for operating activities	(9,500)	(4,478)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(6,476)	(34,259)
Maturities of investments	28,929	56,151
Proceeds from repayment of long-term note receivable	5,000	
Purchases of equipment	(788)	(1,952)
Increase in restricted cash	(290)	(23)
Net cash provided by investing activities	26,375	19,917
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	674	382
Proceeds from employee stock purchase plan	700	852
Net cash provided by financing activities	1,374	1,234
Effect of exchange rate changes on cash and cash equivalents	(247)	(149)
Net increase in cash and cash equivalents	18,002	16,524
Cash and cash equivalents, beginning of period	53,583	40,206

Cash and cash equivalents, end of period	$	71,585	$	56,730
Supplemental disclosure of cash flow information:				
Cash paid during the period for:				
Interest	$		$	2
Income taxes	$	51	$	190
Supplemental disclosure of non-cash transactions:				
Financing of equipment purchases at period end	$	337	$	
Unrealized gain (loss) on available-for-sale securities	$	35	$	(82)

The accompanying notes are an integral part of these financial statements.

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1: ORGANIZATION AND OPERATIONS

Former Nuance Communications, Inc. (together with its subsidiaries, the Company or Former Nuance) was incorporated under the name Nuance Communications, Inc. in July 1994 in the state of California, and subsequently reincorporated in March 2000 in the state of Delaware, to develop, market and support software that enables enterprises and telecommunications carriers to automate the delivery of information and services over the telephone. The Company s software product lines consist of software servers that run on industry-standard hardware and perform speech recognition, natural language understanding and voice authentication. The Company sells its products through a combination of third-party resellers, original equipment manufacturers (OEM) and system integrators and directly to end-users.

On May 9, 2005, the Company and ScanSoft, Inc. (ScanSoft) announced that the two companies had entered into a definitive agreement to merge (the Merger). Under the terms of the Merger Agreement, which has been unanimously approved by both boards of directors, at the completion of the Merger each outstanding share of Former Nuance common stock will be converted into a combination of $2.20 in cash and 0.77 of a share of ScanSoft common stock. In addition, at the closing of the Merger, ScanSoft will assume all of the Company s outstanding stock options with an exercise price below $10.01 per share. All of the Company s other outstanding stock options will be cancelled. Completion of the Merger is subject to customary closing conditions, including receipt of required approvals from the stockholders of the Company and ScanSoft and receipt of required regulatory approvals. The Merger, which is expected to close in the third calendar quarter of 2005, may not be completed if any of the conditions are not satisfied.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation

Basis of Presentation. The Company has prepared the accompanying financial data for the three and six months ended June 30, 2005 and 2004 pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the U.S. have been condensed or omitted pursuant to such rules and regulations. The following discussion should be read in conjunction with our 2004 Annual Report on Form 10-K.

Use of Estimates. The preparation of the condensed consolidated financial statements in conformity with Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. Such estimates include, but are not limited to; allowance for doubtful accounts, restructuring reserve, income taxes, contingencies and percentage of completion estimates of certain revenue contracts. Actual results could differ from those estimates.

Certain Significant Risks and Uncertainties. The Company operates in a dynamic and highly competitive industry and believes that any of the following potential factors could have a material adverse effect on the Company s future financial position, results of operations or cash flows: the volatility of, and rapid change in, the speech software industry; potential competition, including competition from larger, more established companies with newer, better, or less expensive products or services; the Company s dependence on key employees for technology and support; the

Company s failure to adopt, or develop products based on, new industry standards; changes in the overall demand by customers and consumers for speech software products generally, and for the Company s products in particular; changes in, or the loss of, certain strategic relationships (particularly reseller relationships); the loss of a significant customer(s) or order(s); litigation or claims against the Company related to intellectual property, products, regulatory obligations or other matters;

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the Company s inability to protect its proprietary intellectual property rights; adverse changes in domestic and international economic and/or political conditions or regulations; the Company s inability to attract and retain employees necessary to support growth; liability with respect to the Company s software and related claims if such software is defective or otherwise does not function as intended; a lengthy sales cycle which could result in the delay or loss of potential sales orders; seasonal variations in the Company s sales due to patterns in the budgeting and purchasing cycles of our customers; the Company s inability to manage its operations and resources in accordance with market conditions; the need for an increase in the Company s restructuring reserve for the Pacific Shores facility; the failure to realize anticipated benefits from any potential acquisition of companies, products, or technologies; the Company s inability to collect amounts owed to it by its customers; and the Company s inability to develop localized versions of its products to meet international demand.

In the opinion of management, the accompanying condensed consolidated financial statements contain all normal and recurring adjustments necessary to present fairly our condensed consolidated financial position as of June 30, 2005 and December 31, 2004, condensed consolidated results of operations for the three and six months ended June 30, 2005 and 2004, and cash flow activities for the six months ended June 30, 2005 and 2004.

The preparation of financial statements in accordance with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the amounts reported in our condensed consolidated financial statements and accompanying notes. Management bases its estimates on historical experience and various other assumptions believed to be reasonable. Although these estimates are based on management s best knowledge of current events and actions that may impact the company in the future, actual results may be different from the estimates. Our critical accounting policies are those that affect our financial statements materially and involve difficult, subjective or complex judgments by management. Those policies are revenue recognition, valuation allowance for doubtful accounts, valuation of long-lived assets, restructuring and asset impairment charges and accounting for income taxes.

Reclassification. Non-cash stock-based compensation of $73,000 in 2004 has been combined with Research and development expense in the condensed consolidated statements of operations to conform to the 2005 presentation.

NOTE 3: RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued SFAS No. 123 (Revised 2004) Share-Based Payment (SFAS 123R). SFAS 123R addresses all forms of share-based payment (SBP) awards, including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. SFAS 123R will require the Company to expense SBP awards with compensation cost for SBP transactions measured at fair value. SFAS 123R requires the Company to adopt the new accounting provisions effective for the Company s first quarter of fiscal 2006. The Company has not yet quantified the effects of the adoption of SFAS 123R, but the Company expects that the new standard may result in significant stock-based compensation expense. The pro forma effects on net income and earnings per share if the fair value recognition provisions of the original SFAS 123, which differs from the effect of SFAS 123R, had been applied to stock compensation awards (rather than applying the intrinsic value measurement provisions of Opinion 25) are disclosed in Note 4 of the condensed consolidated financial statements.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-2 (FAS 109-2), Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creations Act (AJCA) of 2004.

The AJCA introduces a limited time 85% dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. FAS 109-2 provides accounting and disclosure guidance for the repatriation provision. Although FAS 109-2 is effective immediately, the Company does not expect to be able to complete its evaluation of the

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

repatriation provision until after Congress or the Treasury Department provides additional clarifying language on key elements of the provision.

In May 2005, the FASB issued SFAS No. 154 Accounting Changes and Error Corrections. SFAS 154 amends APB 20, concerning the accounting for changes in accounting principles, requiring retrospective application to prior periods financial statements of changes in an accounting principle, unless it is impracticable to do so. SFAS 154 is effective for fiscal years beginning after December 15, 2005. The Company will adopt SFAS 154 in fiscal year 2006 but does not expect it to have a significant effect on the Company s financial statements.

In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107 Share-Based Payment . SAB 107 provides guidance related to share-based payment transactions with nonemployees, the transition from nonpublic to public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of Statement 123R in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of Statement 123R, the modification of employee share options prior to adoption of Statement 123R and disclosures in Management s Discussion and Analysis (MD&A) subsequent to adoption of Statement 123R. The provision of SAB 107, as appropriate, will be adopted upon implementation of FAS 123R in fiscal year 2006.

NOTE 4: STOCK-BASED COMPENSATION

The Company accounts for stock-based awards to employees and directors using the intrinsic value method of accounting in accordance with Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees. Under the intrinsic value method, the Company records compensation expense related to stock options in the consolidated statement of operations when the exercise price of its employee stock-based award is less than the market price of the underlying stock on the date of the grant. Pro forma net loss and net loss per share information, as required by SFAS No. 123, Accounting for Stock-Based Compensation, has been determined as if the Company had accounted for all employee stock options granted, including shares issuable to employees under the Employee Stock Purchase Plan, under SFAS No. 123 s fair value method. The Company amortizes the fair value of stock options on a straight-line basis over the required periods.

The pro forma effect of recognizing compensation expense in accordance with SFAS No. 123 is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	**2004**	**2005**	**2004**
Net loss, as reported	$ (6,667)	$ (1,596)	$ (11,218)	$ (4,203)
Add: Stock-based employee compensation expense in net loss				73
	(3,723)	(7,086)	(8,048)	(15,307)

Less: Total stock-based employee compensation expense under fair value method for all awards					
Pro forma net loss		$ (10,390)	$ (8,682)	$ (19,266)	$ (19,437)
Basic and diluted net loss per share	as reported	$ (0.18)	$ (0.05)	$ (0.31)	$ (0.12)
Basic and diluted net loss per share	pro forma	$ (0.29)	$ (0.25)	$ (0.53)	$ (0.55)

FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 5: NET LOSS PER SHARE

Net loss per share is calculated under SFAS No. 128, Earnings Per Share. Basic net loss per share on a historical basis is computed by dividing the net loss attributable to common shareholders by the weighted average number of shares of common stock outstanding for the period, excluding the weighted average common shares subject to repurchase. Diluted net loss per share is equal to basic net loss per share for all periods presented since potential common shares from conversion of the convertible preferred stock, stock options, warrants and exchangeable shares held in escrow are anti-dilutive. Shares subject to repurchase resulting from early exercises of options that have not vested are excluded from the calculation of basic net loss per share.

During the three and six months ended June 30, 2005 and 2004, the Company had securities outstanding which could potentially dilute basic earnings per share in the future, but were excluded in the computation of diluted loss per share in such periods, as their effect would have been anti-dilutive due to the net loss reported in such periods. The total number of shares excluded from diluted net loss per share was 9,708,484 and 9,887,855, respectively for the three and six months ended June 30, 2005. The total number of shares excluded from diluted net loss per share was 10,184,377 and 9,941,505, respectively for the three and six months ended June 30, 2004.

The following table presents the calculation of basic and diluted net loss per share (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	**2004**	**2005**	**2004**
Net loss	$ (6,667)	$ (1,596)	$ (11,218)	$ (4,203)
Basic and diluted shares:				
Weighted average shares used to compute basic and diluted shares:	36,435	35,386	36,278	35,226
Basic and diluted net loss per share	$ (0.18)	$ (0.05)	$ (0.31)	$ (0.12)

NOTE 6: INVESTMENTS

The Company classifies investment securities based on management s intention on the date of purchase and reevaluates such designation as of each balance sheet date. Securities are classified as available-for-sale and carried at fair value, which is determined based on quoted market prices, with net unrealized gains and losses included in Accumulated other comprehensive income in the accompanying condensed consolidated balance sheets.

The Company s investments are comprised of U.S. Treasury notes, U.S. Government agency bonds, corporate bonds and commercial paper. Investments with remaining maturities of less than one year are considered to be short-term. All investments are held in the Company s name at major financial institutions. The Company s investment policy allows maturities of investments not in excess of 14 months. As of June 30, 2005, the Company had no investment subject to other-than-temporary impairment.

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 7: INTANGIBLE ASSETS

Information regarding the Company s intangible assets follows (in thousands):

	As of June 30, 2005			
	Gross Amount	Accumulated Amortization	Net	Remaining Life
Patents purchased	$ 375	$ (213)	$ 162	27 months
Purchased technology	2,618	(2,406)	212	8 months
Total	$ 2,993	$ (2,619)	$ 374	

	As of December 31, 2004			
	Gross Amount	Accumulated Amortization	Net	Remaining Life
Patents purchased	$ 375	$ (175)	$ 200	33 months
Purchased technology	2,618	(2,238)	380	14 months
Total	$ 2,993	$ (2,413)	$ 580	

As of June 30, 2005, total estimated amortization of the Patents purchased and the Purchased technology, for the next three years, is as follows (in thousands):

Year Ending December 31,	Amortization Expense
2005 (remaining six months)	$ 207
2006	117
2007	50
Total	$ 374

NOTE 8: COMPREHENSIVE LOSS

The Company reports comprehensive loss by major components and in a single total, the change in its net assets from non-owner sources, which for the Company, is foreign currency translation adjustments and changes in unrealized gains and losses on investments.

The following table presents the components of comprehensive loss for the three and six months ended June 30, 2005 and 2004 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Net loss	$ (6,667)	$ (1,596)	$ (11,218)	$ (4,203)
Unrealized gain (loss) on investments	53	(96)	35	(82)
Foreign currency translation loss	(78)	(146)	(195)	(149)
Comprehensive loss	$ (6,692)	$ (1,838)	$ (11,378)	$ (4,434)

NOTE 9: GUARANTEES, WARRANTIES AND INDEMNITIES

Guarantees

As of June 30, 2005, the Company s financial guarantees consist of standby letters of credit outstanding which are secured by certificates of deposit, representing the restricted cash requirements collateralizing the

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Company s lease obligations. The following table presents the maximum amount of potential future payment under certain facilities lease arrangements and statutory requirements presented as restricted cash on the Company s condensed consolidated balance sheet at June 30, 2005 (in thousands):

Description	Location	Amount
Pacific Shores	California	$ 10,907
Montreal lease	Montreal, Canada	201
Italian VAT filing	Italy	279
Brazil building lease	Brazil	11
Total		$ 11,398

Warranty

The Company does not maintain a general warranty reserve for estimated costs of product warranties at the time revenue is recognized due to the effectiveness of its extensive product quality program and processes.

Indemnifications to Customers

The Company defends and indemnifies its customers for damages and reasonable costs incurred in any suit or claim brought against them alleging that the Company s products sold to its customers infringe any U.S. patent, copyright, trade secret or similar right. If a product becomes the subject of an infringement claim, the Company may, at its option: (i) replace the product with another non-infringing product that provides substantially similar performance; (ii) modify the infringing product so that it no longer infringes but remains functionally equivalent; (iii) obtain the right for the customer to continue using the product at the Company s expense and for the third-party reseller to continue selling the product; (iv) take back the infringing product and refund to customer the purchase price paid less depreciation amortized on a straight line basis. The Company has not been required to make material payments pursuant to these provisions historically. The Company has not identified any losses that are probable under these provisions and, accordingly, the Company has not recorded a liability related to these indemnification provisions.

Indemnifications to Officers and Directors

The Company s corporate by-laws require that the Company indemnify its officers and directors, as well as those who act as directors and officers of other entities at its request, against expenses, judgments, fines, settlements and other amounts actually and reasonably incurred in connection with any proceedings arising out of their services to the Company. In addition, the Company has entered into separate indemnification agreements with each director, each board-appointed officer of the Company and certain other key employees of the Company that provides for indemnification of these directors, officers and employees under similar circumstances. The indemnification obligations are more fully described in the by-laws and the indemnification agreements. The Company purchases insurance to cover claims, or a portion of claims, made against its directors and officers. Since a maximum obligation of the Company is not explicitly stated in the Company s by-laws or in its indemnification agreements and will depend on the facts and circumstances that arise out of any future claims, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, the Company has not made payments related to these obligations, and the estimated fair value for these obligations is zero on the condensed consolidated balance sheet as of June 30, 2005.

Other Indemnifications

As is customary in the Company s industry and as provided for in local law in the U.S. and other jurisdictions, many of its standard contracts provide remedies to others with whom the Company enters into

FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

contracts, such as defense, settlement, or payment of judgment for intellectual property claims related to the use of its products. From time to time, the Company indemnifies its suppliers, contractors, lessors, lessees and others with whom the Company enters into contracts, against combinations of loss, expense, or liability arising from various trigger events related to the sale and the use of its products and services, the use of their goods and services, the use of facilities, the state of the assets and businesses that the Company sells and other matters covered by such contracts, usually up to a specified maximum amount. In addition, from time to time the Company also provides protection to these parties against claims related to undiscovered liabilities, additional product liability or environmental obligations. In the Company s experience, claims made under such indemnifications are rare and the associated estimated fair value of the liability is not material. At June 30, 2005, there were no outstanding claims for such indemnifications.

NOTE 10: RESTRUCTURING

In 2001, the Company decided not to occupy its Pacific Shores facility. This decision resulted in a lease loss comprised of sublease loss, broker commissions and other facility costs. To determine the sublease loss, the loss after the Company s cost recovery efforts to sublease the building, certain assumptions were made relating to the (1) time period over which the building would remain vacant, (2) sublease terms and (3) sublease rates. The Company established the reserves at the low end of the range of estimable cost against outstanding commitments, net of estimated future sublease income. These estimates were derived using the guidance provided in SAB No. 100, Restructuring and Impairment Charges, and EITF No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring). The lease loss may be adjusted in the future upon triggering events (change in estimate of time to sublease, actual sublease rates, or other factors as these changes become known).

The restructuring reserve balance as of December 31, 2004 was $62.9 million. During the first quarter of 2005, the Company incurred $79,000 as consulting expense in order to get property tax refunds of $130,000, resulting in restructuring credit of $51,000. During the second quarter of 2005 the Company received property tax and common area maintenance refunds of approximately $47,000 that were prepaid during 2004, which resulted in a $47,000 restructuring credit.

In September 2004, with the approval of its Board of Directors, the Company commenced streamlining operations in the Engineering and Product Management departments in the California location in order to reallocate resources to its sales operations and outbound marketing efforts. This resulted in the displacement of 16 employees and the Company recorded a severance charge of $574,000 as restructuring expense on the condensed consolidated statement of operations. As of June 30, 2005 all 16 employees had been displaced. For the six months ended June 30, 2005, severance in the amount of $41,900 was paid. The Company anticipates cash payments for outplacement services and other related expenses of $39,000 to be paid by the end of 2005.

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The restructuring expenses and reserve balance are as follows (in thousands):

	Lease Loss	Severance and Related	Asset Write Down	Total Restructuring
2001 Plan				
Balance at December 31, 2004	$ 62,827	$	$	$ 62,827
Total charges for the quarter ended March 31, 2005	(51)			(51)
Amount utilized in the quarter ended March 31, 2005	(2,390)			(2,390)
Adjustment related to property tax refund	130			130
Balance at March 31, 2005	$ 60,516			$ 60,516
Total charges refunded in the quarter ended June 30, 2005	(47)			(47)
Amount utilized in the quarter ended June 30, 2005	(2,412)			(2,412)
Balance at June 30, 2005	$ 58,057	$	$	$ 58,057
2001 Plan reserve balance at June 30, 2005:				
Current restructuring reserve	$ 10,283	$	$	$ 10,283
Long-term restructuring reserve	$ 47,774	$	$	$ 47,774
Q3 2004 Plan				
Balance at December 31, 2004	$	$ 81	$	$ 81
Amount utilized in the quarter ended March 31, 2005		(42)		(42)
Balance at March 31, 2005	$	$ 39	$	$ 39
Amount utilized in the quarter ended June 30, 2005				
Balance at June 30, 2005	$	$ 39	$	$ 39
Summary balance at June 30, 2005 (two plans together):				
Current restructuring reserve	$ 10,283	$ 39	$	$ 10,322
Long-term restructuring reserve	$ 47,774	$	$	$ 47,774

NOTE 11: COMMITMENTS AND CONTINGENCIES

Operating leases

In May 2000, the Company entered into a lease for its Pacific Shore facility. The lease has an eleven-year term, which began in August 2001. A $10.9 million certificate of deposit secures a letter of credit required by the landlord for a rent deposit. In conjunction with the April 2001 restructuring plans, the Company decided not to occupy this leased facility. The future minimum lease payments table referenced below does not include estimated sublease income, as there are no sublease commitments as of June 30, 2005.

In June 2004, the Company signed lease agreements for three office buildings in the Menlo Park location, under which the Company leases an aggregate of approximately 49,000 square feet. Each of the leases has a five-year term, expiring in August 2009 without renewal options. The initial aggregate monthly cash payment for these three leases totals approximately $42,000.

The Company leases its facilities under non-cancelable operating leases with various expiration dates through July 2012. Rent expense is recognized on a straight-line basis over the lease term for leases that have scheduled rental payment increases. Rent expense for the three and six months ended June 30, 2005 was

FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

approximately $298,000 and $501,000, respectively. Rent expense for the three and six months ended June 30, 2004 was approximately $521,000 and $1,053,000, respectively.

As of June 30, 2005, future minimum lease payments under these agreements, including the Company s unoccupied leased facility and lease loss portion of the restructuring reserve, are as follows (in thousands):

Year Ending December 31,	
2005 (remaining six months)	$ 4,673
2006	9,286
2007	9,495
2008	9,535
2009	9,648
Thereafter	25,500
Total future minimum lease payments	$ 68,137

Employment Agreements

In March, 2005, the Company entered into a Change of Control and Retention Agreement (the Retention Agreement) with each of its officers, other than its Chief Executive Officer, who are subject to the reporting requirements of Section 16 of the Securities Exchange Act of 1934, as amended (the Act) and two other officers. On December 2, 2004, the Board of Directors (the Board) of the Company authorized its Chief Executive Officer to cause the Company to enter into such agreements, with certain specified terms, and such other terms as he may determine are appropriate, with such officers and other officers of the Company he may select. Under the terms of the Retention Agreement, in the event of a Change of Control of the Company, each officer that is a party to the agreement will be entitled, if terminated without cause or constructively terminated with good reason within 18 months after the Change of Control, (a) to receive a cash severance payment equal to her or his annual salary and annual bonus (50% of such amounts, in the case of the other officers), and (b) to have accelerated the vesting of 50% of his or her unvested options to purchase common stock of the Company, in the case of the Section 16 Officers, and 50% of such amount, in the case of the other officers.

Other Contingencies

In August 2001, the first of a number of complaints was filed, in the United States District Court for the Southern District of New York, on behalf of a purported class of persons who purchased the Company s stock between April 12, 2000, and December 6, 2000. Those complaints have been consolidated into one action. The complaint generally alleges that various investment bank underwriters engaged in improper and undisclosed activities related to the allocation of shares in the Company s initial public offering of securities. The complaint makes claims for violation of several provisions of the federal securities laws against those underwriters, and also against the Company and some of the Company s directors and officers. Similar lawsuits, concerning more than 250 other companies initial public offerings, were filed in 2001. In February 2003, the Court denied a motion to dismiss with respect to the claims against the Company. In the third quarter of 2003, a proposed settlement in principle was reached among the plaintiffs, issuer defendants (including the Company) and the issuers insurance carriers. The settlement calls for the dismissal and release of claims against the issuer defendants, including the Company, in exchange for a contingent payment to be paid, if necessary, by the issuer defendants insurance carriers and an assignment of certain claims. The timing of the conclusion of the settlement remains unclear, and the settlement is subject to a number of conditions, including approval of the Court. The settlement is not expected to have any material impact upon the Company, as payments, if any, are expected to be made by insurance carriers, rather than by the Company. In July 2004, the underwriters filed a motion opposing approval by the court of the settlement among the

FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

plaintiffs, issuers and insurers. In March 2005, the court granted preliminary approval of the settlement, subject to the parties agreeing to modify the term of the settlement which limits each underwriter from seeking contribution against its issuer for damages it may be forced to pay in the action. In the event a settlement is not concluded, the Company intends to defend the litigation vigorously. The Company believes it has meritorious defenses to the claims against the Company.

On May 18, 2005, the Company received a copy of a complaint naming Former Nuance and the members of its board of directors as defendants in a lawsuit filed, on May 13, 2005, in the Superior Court of the State of California, County of San Mateo, by Mr. Frank Capovilla, on behalf of himself and, purportedly, the holders of the Company s common stock. The complaint alleges, among other things, that the Company s board of directors breached their fiduciary duties to the Company s stockholders respecting the Merger Agreement that was entered into with ScanSoft. The complaint seeks to declare that the Merger Agreement is unenforceable. The complaint also seeks an award of attorney s and expert s fees. The Company believes the allegations of this lawsuit are without merit and expects that the Company and its directors will vigorously contest the action.

In addition, the Company is subject, from time to time, to various other legal proceedings, claims and litigation that arise in the normal course of business. While the outcome of any of these matters is currently not determinable, management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on the Company s consolidated financial position, results of operations or cash flows.

NOTE 12: SEGMENT REPORTING

The Company s operating segments are defined as components of the Company, about which separate financial information is available, that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Company s chief operating decision maker is the Chief Executive Officer of the Company.

Revenues are generated from three primary sources: (1) software licenses; (2) services, which include consulting services and education services; and (3) maintenance, which include software license updates and customer technical support. Revenues for the segments are identical to those presented on the accompanying condensed consolidated statements of operations. The Company does not track expenses or derive profit or loss based on these segments.

Sales of licenses, as well as services and maintenance, through June 30, 2005, occurred through third-party resellers and through direct sales representatives located in the Company s headquarters in Menlo Park, California, and in other locations. These sales were supported through the Menlo Park location. The Company does not separately report costs by region internally.

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Revenues are based on the country in which the end-user is located. The following is a summary of license, service and maintenance revenue by geographic region (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
License revenue:				
United States	$ 2,881	$ 4,972	$ 5,582	$ 9,194
Canada	813	1,174	1,507	1,951
Europe	639	834	926	1,095
Asia Pacific	197	184	593	374
Latin America	11	5	96	58
Total license revenue	$ 4,541	$ 7,169	$ 8,704	$ 12,672
Service revenue:				
United States	$ 1,503	$ 1,564	$ 3,230	$ 2,700
Canada	372	319	832	623
Europe	4	115	85	307
Asia Pacific	726	1,391	2,092	3,265
Latin America		23		79
Total service revenue	$ 2,605	$ 3,412	$ 6,239	$ 6,974
Maintenance revenue:				
United States	$ 2,608	$ 2,397	$ 5,135	$ 4,671
Canada	612	530	1,208	1,031
Europe	398	385	788	750
Asia Pacific	345	345	687	686
Latin America	148	155	297	311
Total service revenue	$ 4,111	$ 3,812	$ 8,115	$ 7,449
Total revenue:				
United States	$ 6,992	$ 8,933	$ 13,947	$ 16,565
Canada	1,797	2,023	3,547	3,605
Europe	1,041	1,334	1,799	2,152
Asia Pacific	1,268	1,920	3,372	4,325
Latin America	159	183	393	448
Total revenue	$ 11,257	$ 14,393	$ 23,058	$ 27,095

NOTE 13: RELATED PARTIES

Certain members of the Company s Board of Directors also serve as directors for companies to which the Company sells products in the ordinary course of its business. The Company believes that the terms of its transactions with those companies are no less favorable to the Company than the terms that would have been obtained absent those relationships.

Specifically, (1) one member of the Company s Board of Directors is on the Board of Directors of Wells Fargo, which is a customer of the Company, (2) one reseller, EPOS, is a wholly owned subsidiary of

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Tier Technologies, for which the Company s President and CEO, Charles W. Berger, serves as a director, (3) one member of the Company s Board of Directors is also on the Board of Directors of BeVocal, a customer of the Company, and (4) in 2004 one member of the Company s Board of Directors was also on the Board of Directors of MCI, a customer of the Company.

The following table summarizes the revenue generated from these customers for the three and six months ended June 30, 2005 and 2004, (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	**2004**	**2005**	**2004**
Wells Fargo	$ 146	$ 51	$ 330	$ 164
MCI		223		381
BeVocal	23		23	
EPOS	42		160	
Total	$ 211	$ 274	$ 513	$ 545

The following table summarizes the amounts owed to the Company by these customers as of June 30, 2005 and December 31, 2004 (in thousands):

	June 30, 2005	As of December 31, 2004
Wells Fargo	$ 15	$ 43
MCI		303
BeVocal	29	
EPOS	9	94
Total	$ 53	$ 440

NOTE 14: MERGER OF THE COMPANY WITH SCANSOFT, INC.

On May 9, 2005, the Company and ScanSoft, Inc. announced that the two companies had entered into a definitive agreement to merge. Under the terms of the Merger Agreement, which has been unanimously approved by both boards of directors, at the completion of the Merger each outstanding share of Former Nuance common stock will be converted into a combination of $2.20 in cash and 0.77 of a share of ScanSoft common stock. In addition, at the closing of the Merger, ScanSoft will assume all of the Company s outstanding stock options with an exercise price below $10.01 per share. All of the Company s other outstanding stock options will be cancelled. Completion of the Merger is subject to customary closing conditions, including receipt of required approvals from the stockholders of the Company and ScanSoft and receipt of required regulatory approvals. The Merger, which is expected to close in the third calendar quarter of 2005, may not be completed if any of the conditions are not satisfied.

Under terms specified in the Merger Agreement, the Company or ScanSoft may terminate the Merger, in which case, the terminating party may be required to pay a termination fee equal to 3% of the aggregate value of the transaction to the other party in certain circumstances. During the second quarter of 2005 the Company

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

recorded approximately $2.6 million in Merger related expenses. The following table presents the major components of merger expenses (in thousands):

Description	Amount
Retention bonuses	$ 710
Legal	682
Accounting and consulting fees	280
Investment banker fees	930
Total merger expenses	$ 2,602

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Former Nuance Communications, Inc.

Annual Financial Statements

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Former Nuance Communications, Inc. and Subsidiaries:
Menlo Park, California

We have audited the accompanying consolidated balance sheets of Former Nuance Communications, Inc. and subsidiaries (the Company) as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders equity and comprehensive loss, and cash flows for each of the three years in the period ended December 31, 2004. Our audits also included the consolidated financial statement schedule listed in the Index as Schedule II. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2004 and 2003, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of December 31, 2004, based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 15, 2005 (not presented herein) expressed an unqualified opinion on management s assessment of the effectiveness of the Company s internal control over financial reporting and an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

San Jose, California
March 15, 2005

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2004	December 31, 2003
	(In thousands, except share and per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 53,583	$ 40,206
Short-term investments	37,493	66,599
Accounts receivable, net of allowance for doubtful accounts of $583 and $837, respectively	13,953	13,934
Prepaid expenses and other current assets	3,839	4,246
Total current assets	108,868	124,985
Property and equipment, net	4,059	3,937
Long-term note receivable	5,005	
Intangible assets, net	580	993
Restricted cash	11,109	11,113
Deferred income taxes	398	254
Other assets	238	215
Total assets	$ 130,257	$ 141,497
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,328	$ 1,086
Accrued liabilities	8,067	6,920
Current restructuring accrual	10,203	9,554
Current deferred revenue	8,157	7,731
Current portion of capital lease		33
Total current liabilities	27,755	25,324
Long-term deferred revenue	544	699
Long-term restructuring accrual	52,705	42,891
Other long-term liabilities	37	22
Total liabilities	81,041	68,936
Commitments and contingencies (Note 12)		
Stockholders Equity:		
Common stock, $0.001 par value, 250,000,000 shares authorized; 36,077,623 and 34,995,251 shares issued and outstanding, respectively	36	35

Additional paid-in capital	332,521	329,975
Accumulated other comprehensive income	1,035	748
Accumulated deficit	(284,376)	(258,197)
Total stockholders equity	49,216	72,561
Total liabilities and stockholders equity	$ 130,257	$ 141,497

The accompanying notes are an integral part of these consolidated financial statements.

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31, 2004	2003	2002
	(In thousands, except per share data)		
Revenue:			
License	$ 26,409	$ 28,207	$ 26,783
Service	15,806	14,266	8,191
Maintenance	15,662	12,565	9,111
Total revenue	57,877	55,038	44,085
Cost of revenue:			
License	396	370	641
Service(1)	10,460	9,982	7,680
Maintenance(1)	2,634	2,548	3,374
Total cost of revenue	13,490	12,900	11,695
Gross profit	44,387	42,138	32,390
Operating expenses:			
Sales and marketing(1)	26,727	28,179	39,712
Research and development(1)	14,504	15,310	14,153
General and administrative(1)	11,037	11,533	13,393
Non-cash compensation expense	73	28	928
Restructuring charges and asset impairments	19,737	9,375	37,275
Total operating expenses	72,078	64,425	105,461
Loss from operations	(27,691)	(22,287)	(73,071)
Interest and other income, net	1,097	1,180	2,687
Loss before income taxes	(26,594)	(21,107)	(70,384)
Provision for (benefit from) income taxes	(415)	(1,806)	800
Net loss	$ (26,179)	$ (19,301)	$ (71,184)
Basic and diluted net loss per share	$ (0.74)	$ (0.56)	$ (2.11)
Shares used to compute basic and diluted net loss per share	35,487	34,471	33,666

(1) Excludes non-cash compensation expense as follows:

	Year Ended December 31,		
	2004	2003	2002
Service and maintenance cost of revenue	$	$ 1	$ 58
Sales and marketing		2	264
Research and development	73	6	423
General and administrative		19	183
	$ 73	$ 28	$ 928

The accompanying notes are an integral part of these consolidated financial statements.

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE LOSS

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Deferred Stock Compensation	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Stockholders Equity	Comprehensive Loss
	(In thousands, except share amounts)							
Balance at January 1, 2002	33,198,051	$ 33	$ 324,371	$ (1,532)	$ (335)	$ (167,712)	$ 154,825	$
Exercise of common stock options	307,330		498				498	
Repurchase of common stock	(3,355)		(11)				(11)	
Reversal of issuance of stock repurchased in prior year	10,000		72				72	
ESPP common stock issued	614,923	1	2,049				2,050	
Amortization of deferred stock compensation				928			928	
Deferred stock compensation adjustment			(383)	383				
Issuance of shares for representations and warranties related to SpeechFront	16,588		1,743				1,743	
Issuance of shares relating to SpeechFront founders retention and product milestones (See Note 4)	38,707							
Unrealized gain on available-for-sale securities					284		284	284

Foreign currency translation gain					68		68	68
Net loss						(71,184)	(71,184)	(71,184)
Balance at December 31, 2002	34,182,244	$ 34	$ 328,339	$ (221)	$ 17	$ (238,896)	$ 89,273	$ (70,832)
Exercise of common stock options	226,828		675				675	
ESPP common stock issued	586,179	1	1,154				1,155	
Amortization of deferred stock compensation				28			28	
Deferred stock compensation adjustment			(193)	193				
Unrealized loss on available-for-sale securities					(155)		(155)	(155)
Foreign currency translation gain					886		886	886
Net loss						(19,301)	(19,301)	(19,301)
Balance at December 31, 2003	34,995,251	$ 35	$ 329,975	$	$ 748	$ (258,197)	$ 72,561	$ (18,570)
Exercise of common stock options	376,726		982				982	
ESPP common stock issued	705,646	1	1,564				1,565	
Unrealized loss on available-for-sale securities					(141)		(141)	(141)
Foreign currency translation gain					428		428	428
Net loss						(26,179)	(26,179)	(26,179)
Balance at December 31, 2004	36,077,623	$ 36	$ 332,521	$	$ 1,035	$ (284,376)	$ 49,216	$ (25,892)

The accompanying notes are an integral part of these consolidated financial statements.

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2004	2003	2002
	(In thousands)		
Cash flows from operating activities:			
Net loss	$ (26,179)	$ (19,301)	$ (71,184)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	2,586	3,804	4,287
Loss on fixed asset disposals	134	198	13
Amortization of intangible assets	413	412	568
Non-cash compensation expense	73	28	928
Allowance for doubtful accounts (recoveries)	(254)	167	(642)
Deferred income taxes	(144)	180	(141)
Asset impairments			887
Write-off of excess purchased software			275
Changes in operating assets and liabilities:			
Accounts receivable	235	(5,751)	(1,309)
Prepaid expenses, other current assets and other assets	403	2,104	(1,112)
Restructuring accrual	10,463	(240)	23,542
Accounts payable	242	(505)	206
Accrued liabilities and other long-term liabilities	1,129	(2,192)	(1,211)
Deferred revenue	271	(524)	(1,882)
Net cash used in operating activities	(10,628)	(21,620)	(46,775)
Cash flows from investing activities:			
Purchase of investments	(117,784)	(109,699)	(109,524)
Maturities of investments	146,725	126,682	68,030
Purchase of property and equipment	(2,842)	(1,609)	(3,016)
Long-term note receivable from Spanlink	(5,000)		
Purchase of intangible assets			(375)
(Increase) decrease in restricted cash	4	(35)	137
Net cash provided by (used in) investing activities	21,103	15,339	(44,748)
Cash flows from financing activities:			
Proceeds from Employee Stock Purchase Plan	1,565	1,155	2,049
Proceeds from exercise of common stock options	909	675	498
Reversal of issuance of stock purchased in prior year			72
Repurchase of common stock			(11)
Net cash provided by financing activities	2,474	1,830	2,608

Effect of exchange rate fluctuations		428		886		68
Net increase (decrease) in cash and cash equivalents		13,377		(3,565)		(88,847)
Cash and cash equivalents, beginning of period		40,206		43,771		132,618
Cash and cash equivalents, end of period	$	53,583	$	40,206	$	43,771
Supplementary disclosures of cash flow information:						
Cash paid during the period for:						
Interest	$	4	$	27	$	40
Income taxes	$	382	$	1,013	$	536
Supplementary disclosures of non-cash transactions:						
Unrealized gain (loss) on available-for-sale securities	$	(141)	$	(155)	$	284
Issuance of shares related to SpeechFront	$		$		$	1,743

The accompanying notes are an integral part of these consolidated financial statements.

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND OPERATIONS

Former Nuance Communications, Inc. (together with its subsidiaries, the Company) was incorporated under the name Nuance Communications, Inc. (see Note 19) in July 1994 in the state of California, and subsequently reincorporated in March 2000 in the state of Delaware, to develop, market and support software that enables enterprises and telecommunications carriers to automate the delivery of information and services over the telephone. The Company s software product lines consist of software servers that run on industry-standard hardware and perform speech recognition, natural language understanding and voice authentication. The Company sells its products through a combination of third-party resellers, original equipment manufacturers (OEM) and system integrators and directly to end-users.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant inter-company transactions and balances have been eliminated.

Use of Estimates

The preparation of the consolidated financial statements in conformity with Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. Such estimates include, but are not limited to, allowance for doubtful accounts, restructuring accrual, income taxes, contingencies and percentage of completion estimates of certain revenue contracts. Actual results could differ from those estimates.

Certain Significant Risks and Uncertainties

The Company operates in a dynamic and highly competitive industry and believes that any of the following potential factors could have a material adverse effect on the Company s future financial position, results of operations or cash flows: the volatility of, and rapid change in, the speech software industry; potential competition, including competition from larger, more established companies with newer, better, or less expensive products or services; the Company s dependence on key employees for technology and support; the Company s failure to adopt, or develop products based on, new industry standards; changes in the overall demand by customers and consumers for speech software products generally, and for the Company s products in particular; changes in, or the loss of, certain strategic relationships (particularly reseller relationships); the loss of a significant customer(s) or order(s); litigation or claims against the Company related to intellectual property, products, regulatory obligations or other matters; the Company s inability to protect its proprietary intellectual property rights; adverse changes in domestic and international economic and/or political conditions or regulations; the Company s inability to attract and retain employees necessary to support growth; liability with respect to the Company s software and related claims if such software is defective or otherwise does not function as intended; a lengthy sales cycle which could result in the delay or loss of potential sales orders; seasonal variations in the Company s sales due to patterns in the budgeting and purchasing cycles of our customers; the Company s inability to manage its operations and resources in accordance with market conditions; the need for an increase in the Company s restructuring accrual for the Pacific Shores facility; the failure to realize anticipated benefits from any potential acquisition of companies, products, or technologies; the Company s inability to collect amounts owed to it by its customers; and the Company s inability to develop localized versions of its products to meet international demand.

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less, when purchased, to be cash equivalents. Cash and cash equivalents consist of money market accounts, certificates of deposit and deposits with banks. Cash and cash equivalents are recorded at cost which approximates fair value.

Valuation Allowance for Doubtful Accounts

The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history and the customer s current creditworthiness, as determined by the Company s review of their current credit information. The Company continually monitors collections and payments from customers and maintains a provision for estimated credit losses based on a percentage of its accounts receivable, the historical experience and any specific customer collection issues that the Company has identified. While such credit losses have historically been within the Company s expectations and appropriate reserves have been established, the Company cannot guarantee that it will continue to experience the same credit loss rates that the Company has experienced in the past. Material differences may result in the amount and timing of revenue and or expenses for any period if management made different judgments or utilized different estimates.

Investments

The Company s investments are comprised of U.S. Treasury notes, U.S. Government agency bonds, corporate bonds and commercial paper. Investments with remaining maturities of less than one year are considered to be short-term. All investments are held in the Company s name at major financial institutions. At December 31, 2004, all of the Company s investments were classified as available-for-sale and carried at fair value, which is determined based on quoted market prices, with net unrealized gains or losses included in Accumulated other comprehensive income in the accompanying consolidated balance sheets. Gains and losses are recognized in income when realized. As of December 31, 2004, the Company had no investment subject to other-than-temporary impairment.

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets as follows:

Computer equipment and software	2-3 years
Furniture and fixtures	5 years
Leasehold improvements	Shorter of lease term or estimated useful life

Restricted Cash

The restricted cash represents investments in certificates of deposit. The restricted cash secures letters of credit required by landlords to meet rent deposit requirements for leased facilities in the U.S. and Canada.

Valuation of Long-lived Assets

The Company has assessed the recoverability of long-lived assets, including intangible assets other than goodwill, by determining whether the carrying value of such assets will be recovered through undiscounted future cash flows according to the guidance of Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment of Disposal of Long Lived Assets. The Company assesses whether it will recognize the future benefit of long-lived assets, including intangibles in accordance with the provisions of SFAS No. 144. For assets to be held and used, including acquired intangibles, the Company initiates its review annually or whenever events or changes in circumstances indicate that the carrying amount of a long-

FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

lived asset may not be recoverable. Recoverability of an asset is measured by comparison of its carrying amount to the expected future undiscounted cash flows (without interest charges) that the asset is expected to generate. Any impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. Significant management judgment is required in the forecasting of future operating results which are used in the preparation of projected discounted cash flows and should different conditions prevail, material write downs of net intangible assets and/or goodwill could occur.

The Company assesses the impairment of goodwill in accordance with SFAS No. 142, Goodwill and Other Intangible Assets, .

It is reasonably possible that the estimates of anticipated future gross revenue, the remaining estimated economic life of the products and technologies, or both, could differ from those used to assess the recoverability of these costs and result in a write-down of the carrying amount or a shortened life of acquired intangibles in the future. As of December 31, 2004, the Company has no goodwill balance.

Software Development Costs Software to be sold

Costs incurred in the research and development of software products are expensed as incurred until technological feasibility has been established. Once technological feasibility has been established, these costs are capitalized. The establishment of technological feasibility and the ongoing assessment of the recoverability of these costs requires considerable judgment by management with respect to certain external factors, including, but not limited to, anticipated future gross product revenues, estimated economic life and changes in software and hardware technologies. Amounts that could have been capitalized were insignificant and, therefore, no costs have been capitalized to date.

Software Development Costs Internal use

The Company purchased software for internal use during the twelve months ended December 31, 2004. Therefore, external direct costs of software development and payroll and payroll related costs incurred for time spent on the project by employees directly associated with the development are capitalized after the preliminary project stage is completed. Accordingly, the Company had capitalized $1.0 million and $0 related to software development for internal use as of December 31, 2004 and December 31, 2003, respectively.

Restructuring and Asset Impairment Charges

The Company accrues for restructuring costs when management approves and commits to a firm plan. Historically the main components of the Company s restructuring plans have been related to workforce reductions, lease losses as a result of a decision not to occupy certain leased property and asset impairments. Workforce-related charges are accrued based on an estimate of expected benefits that would be paid out to the employees. To determine the sublease loss, after the Company s cost recovery efforts from subleasing the building, certain assumptions are made relating to the (1) time period over which the building would remain vacant (2) sublease terms and (3) sublease rates. The Company establishes the reserves at the low end of the range of estimable cost against outstanding commitments, net of estimated future sublease income. These estimates are derived using the guidance provided in Staff Accounting Bulletin (SAB) No. 100, Restructuring and Impairment Charges, Emerging Issues Task Force (EITF) No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including

Certain Costs Incurred in a Restructuring) and SFAS No. 146 Accounting for Costs Associated with Exit or Disposal Activities. These reserves are based upon management s estimate of the time required to sublet the property, the amount of sublet income that may be generated between the date the property is not occupied and expiration of the lease for the unoccupied property as well as costs to maintain the property and anticipated costs to sublease the property. These estimates are reviewed and revised quarterly and may result in a substantial increase or

FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

decrease to restructuring expense should different conditions prevail than were anticipated in original management estimates.

Income Taxes

In preparing the Company s consolidated financial statements, the Company is required to estimate its income taxes in each of the jurisdictions in which the Company operates. This process involves estimating actual current tax exposures together with assessing tax credits and temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheet. The Company then assesses the likelihood that deferred tax assets will be recovered from future taxable income, and to the extent it believes that recovery is not likely, the Company must establish a valuation allowance. To the extent the Company establishes a valuation allowance or increases this allowance in a period, the Company includes an expense within the tax provision in its consolidated statement of operations. As of December 31, 2004, the Company had no contingencies.

Significant management judgment is required in determining the Company s provision for income taxes, income tax credits, the Company s deferred tax assets and liabilities and any valuation allowance recorded against its net deferred tax assets. The Company has recorded a valuation allowance due to uncertainties related to its ability to utilize some of its deferred tax assets, primarily consisting of the utilization of certain net operating loss carry forwards and foreign tax credits before they expire. The valuation allowance is based on estimates of taxable income by the jurisdictions in which the Company operates and the period over which deferred tax assets will be recoverable. In the event that actual results differ from these estimates or the Company adjusts these estimates in future periods, the Company may need to establish an additional valuation allowance, which could impact the Company s financial position and results of operations. As of December 31, 2004, the Company had no recorded tax contingencies.

Revenue Recognition

Revenues are generated from licenses, services and maintenance. All revenues generated from the Company s worldwide operations are approved at its corporate headquarters, located in the United States. The Company applies the provisions of Statement of Position (SOP) No. 97-2, Software Revenue Recognition, as amended by SOP No. 98-9, Modification of SOP No. 97-2, Software Revenue Recognition, With Respect to Certain Transactions to all transactions involving the sale of software products. The Company also recognizes some revenue based on SOP No. 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts and EITF No. 03-05 Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software.

The Company s license revenue consists of license fees for its software products. The license fees for the Company s software products are calculated primarily by determining the maximum number of calls that may be simultaneously connected to its software.

For licensed products requiring significant customization, the Company recognizes license revenue using the percentage-of-completion method of accounting over the period that services are performed. For all license and service agreements accounted for under the percentage-of-completion method, the Company determines progress to completion based on actual direct labor hours incurred to date as a percentage of the estimated total direct labor hours required to complete the project. The Company periodically evaluates the actual status of each project to ensure that the estimates to complete each contract remain accurate. A provision for estimated losses on contracts is made in the period in which the loss becomes probable and can be reasonably estimated. To date, these losses have not been significant. Costs incurred in advance of billings are recorded as costs incurred exceed the related billings on uncompleted contracts. If the amount of revenue recognized exceeds the amounts billed to customers, the excess amount is recorded as unbilled accounts receivable. If the

FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

amount billed exceeds the amount of revenue recognized, the excess amount is recorded as deferred revenue. Revenue recognized in any period is dependent on the Company s percentage completion of projects in progress. Significant management judgment and discretion are used to estimate total direct labor hours required to complete the project. Any changes in or deviation from these estimates could have a material effect on the amount of revenue the Company recognizes in any period.

For licensed products that do not require significant customization of components, the Company recognizes revenue from the sale of software licenses when:

- persuasive evidence of an arrangement exists;
- the software and corresponding authorization codes have been delivered;
- the fee is fixed and determinable;
- collection of the resulting receivable is probable.

The Company uses a signed contract and either 1) a purchase order, 2) an order form or 3) a royalty report as evidence of an arrangement.

Products delivered with acceptance criteria or return rights are not recognized as revenue until all revenue recognition criteria are achieved. If undelivered products or services exist that are essential to the functionality of the delivered product in an arrangement, delivery is not considered to have occurred. Delivery is accomplished through electronic distribution of the authorization codes or keys. Occasionally the customer will require that the Company secure their acceptance of the system in addition to the delivery of the keys. Such acceptance, when required, typically consists of a demonstration to the customer that, upon implementation, the software performs in accordance with specified system parameters, such as recognition accuracy or transaction completion rates. In the absence of such required acceptance, the Company will defer revenue recognition until signed acceptance is obtained.

The Company considers the fee to be fixed and determinable when the price is not subject to refund or adjustments.

The Company assesses whether collection of the resulting receivable is probable based on a number of factors, including the customer s past payment history and current financial position. If the Company determines that collection of a fee is not probable, the Company defers recognition of the revenue until the time collection becomes reasonably assured, which is upon receipt of the cash payment.

The Company uses the residual method to recognize revenue when a license agreement includes one or more elements to be delivered at a future date if Vendor Specific Objective Evidence (VSOE) of the fair value of all undelivered elements exists. VSOE of fair value is based on the price charged when the element is sold separately, or if not yet sold separately, is established by authorized management. In situations where VSOE of fair value for undelivered elements does not exist, the entire amount of revenue from the arrangement is deferred and recognized when VSOE of fair value can be established for all undelivered elements or when all such elements are delivered. In situations where the only undelivered element is maintenance and VSOE of fair value for maintenance does not exist, the entire amount of revenue from the arrangement is recognized ratably over the maintenance period. As a general rule, license revenue from third-party resellers is recognized when product has been sold through to an end user and such sales have been reported to the Company. However, certain third-party reseller agreements include time-based provisions on which the Company bases revenue recognition, in these instances, there is no right of returns possible.

The timing of license revenue recognition is affected by whether the Company performs consulting services in the arrangement and the nature of those services. In the majority of cases, the Company either performs no consulting services or the Company performs services that are not essential to the functionality of the software. When the Company performs consulting and implementation services that are essential to the

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

functionality of the software, the Company recognizes both license and consulting revenue utilizing contract accounting based on the percentage of the consulting services that have been completed. This calculation is done in conformity with SOP No. 81-1; however, judgment is required in determining the percentage of the project that has been completed.

Service revenue consists of revenue from providing consulting, training and other revenue. Other revenue consists primarily of reimbursements for consulting out-of-pocket expenses incurred and recognized, in accordance with EITF No. 01-14, Income Statement Characterization of Reimbursements Received for Out-of-Pocket Expenses Incurred. For services revenue, the Company requires 1) a signed contract, 2) statement of work and 3) purchase order or order form prior to recognizing any services revenue. The Company s consulting service contracts are bid either on a fixed-fee basis or on a time-and-materials basis. For a fixed-fee contract, the Company recognizes revenue using the percentage of completion method. For time-and-materials contracts, the Company recognizes revenue as services are performed. Training service revenue is recognized as services are performed. Losses on service contracts, if any, are recognized as soon as such losses become known.

Maintenance revenue consists of fees for providing technical support and software upgrades and updates. The Company requires a signed contract and purchase order prior to recognizing any maintenance revenue. The Company recognizes all maintenance revenue ratably over the contract term for such maintenance. Customers have the option to purchase or decline maintenance agreements at the time of the license purchase. If maintenance is declined, a reinstatement fee is required when the customer decides to later activate maintenance. Customers generally have the option to renew or decline maintenance agreements annually during the contract term.

The Company s standard payment terms are generally net 30 to 90 days from the date of invoice. Thus, a significant portion of the Company s accounts receivable balance at the end of a quarter is primarily comprised of revenue from that quarter.

Deferred Revenue

The Company records deferred revenue primarily as a result of payments from customers received in advance of recognition of revenue.

The deferred revenue amount includes 1) unearned license revenues, which will be recognized as revenue when the appropriate revenue recognition criteria have been met, 2) prepaid maintenance and prepaid or unearned professional services that will be recognized as revenue as the services are performed or contract expiration periods lapse, and 3) license revenue subject to deferral as a result of applying percentage completion to certain contracts.

Foreign Currency Translation and Transactions

The functional currency of the Company s foreign subsidiaries is deemed to be the local country s currency. Consequently, assets and liabilities recorded in foreign currencies are translated at year-end exchange rates; revenues and expenses are translated at average exchange rates during the year. The effects of foreign currency translation adjustments are included in stockholders equity as a component of accumulated other comprehensive income in the accompanying consolidated balance sheets. The effects of foreign currency transactions are included in Interest and other income, net in the accompanying consolidated statement of operations.

Comprehensive loss

In 2001, the Company adopted SFAS No. 130, Reporting Comprehensive Income which requires that an enterprise reports, by major components and in a single total, the change in its net assets from non-owner

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

sources, which for the Company, is foreign currency translation and changes in unrealized gains and losses on investments.

Concentration of Credit Risks

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist primarily of cash and cash equivalents and accounts receivable. Cash and cash equivalents are held with financial institutions and consist of cash in bank accounts that exceed Federally insured limits. The Company does not require its customers to provide collateral or other security to support accounts receivable. To reduce credit risk, management performs ongoing credit evaluations of its customers financial condition and maintains allowances for estimated potential bad debt losses.

Stock-based compensation

The Company accounted for stock-based awards to employees and directors using the intrinsic value method of accounting in accordance with Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees. Under the intrinsic value method, the Company records compensation expense related to stock options in the consolidated statement of operations when the exercise price of its employee stock-based award is less than the market price of the underlying stock on the date of the grant. Pro forma net loss and net loss per share information, as required by SFAS No. 123, Accounting for Stock-Based Compensation, has been determined as if the Company had accounted for all employee stock options granted, including shares issuable to employees under the Employee Stock Purchase Plan, under SFAS No. 123 s fair value method.

The Company amortizes the fair value of stock options on a straight-line basis over the required periods.

The pro forma effect of recognizing compensation expense in accordance with SFAS No. 123 is as follows:

	Year Ended December 31,		
	2004	**2003**	**2002**
Net loss, as reported	$ (26,179)	$ (19,301)	$ (71,184)
Add: Stock-based employee compensation expense included in net loss, net of tax	73	28	541
Less: Total stock-based employee compensation expense under fair value method for all awards, net of tax	(26,400)	(34,145)	(37,305)
Pro forma net loss	$ (52,506)	$ (53,418)	$ (107,948)
Basic and diluted net loss per share as reported	$ (0.74)	$ (0.56)	$ (2.11)
Basic and diluted net loss per share pro forma	$ (1.48)	$ (1.55)	$ (3.21)

Net Loss Per Share

Net loss per share is calculated under SFAS No. 128, Earnings Per Share. Basic net loss per share on a historical basis is computed by dividing the net loss attributable to common shareholders by the weighted average number of shares of common stock outstanding for the period, excluding the weighted average common shares subject to repurchase. Diluted net loss per share is equal to basic net loss per share for all periods presented since potential common shares from conversion of the convertible preferred stock, stock options, warrants and exchangeable shares held in escrow are anti-dilutive. Shares subject to repurchase resulting from early exercises of options that have not vested are excluded from the calculation of basic net loss per share.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. RECENT ACCOUNTING PRONOUNCEMENTS

In January 2003 the Financial Accounting Standards Board (FASB) issued Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46) which was amended by FIN 46R issued in December 2003. FIN 46 addresses consolidation by business enterprises of variable interest entities (VIE s) that either: (1) do not have sufficient equity investment at risk to permit the entity to finance its activities without additional subordinated financial support, or (2) for which the equity investors lack an essential characteristic of a controlling financial interest. FIN 46 requires consolidation of VIE s for which the Company is the primary beneficiary and disclosure of a significant interest in a VIE for which the Company is not the primary beneficiary. As a result of the Company s review, no entities were identified requiring disclosure or consolidation under FIN 46.

In March 2004, the FASB issued EITF No. 03-01, The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments, which provides new guidance for assessing impairment losses on debt and equity investments. The new impairment model applies to investments accounted for under the cost or equity method and investments accounted for under FAS 115, Accounting for Certain Investments in Debt and Equity Securities. EITF No. 03-01 also includes new disclosure requirements for cost method investments and for all investments that are in an unrealized loss position. In September 2004, the FASB delayed the accounting provisions of EITF No. 03-01; however the disclosure requirements remain effective and the applicable ones have been adopted for the year ended December 31, 2004. The Company will evaluate the effect, if any, of EITF 03-01 when final guidance is issued.

In June 2004, the FASB issued Emerging Issues Task Force Issue No. 02-14 (EITF 02-14), Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock. EITF 02-14 addresses whether the equity method of accounting applies when an investor does not have an investment in voting common stock of an investee but exercises significant influence through other means. EITF 02-14 states that an investor should only apply the equity method of accounting when it has investments in either common stock or in-substance common stock of a corporation, provided that the investor has the ability to exercise significant influence over the operating and financial policies of the investee. The accounting provisions of EITF 02-14 are effective for reporting periods beginning after September 15, 2004. Adoption of EITF 02-14 did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In December 2004, the FASB issued SFAS No. 123 (Revised 2004) Share-Based Payment (SFAS No. 123R). SFAS No. 123R addresses all forms of share-based payment (SBP) awards, including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. SFAS No. 123R will require the Company to expense SBP awards with compensation cost for SBP transactions measured at fair value. SFAS No. 123R requires the Company to adopt the new accounting provisions effective for the Company s third quarter of 2005. The Company has not yet quantified the effects of the adoption of SFAS 123R, but the Company expects that the new standard may result in significant stock-based compensation expense. The pro forma effects on net income and earnings per share if the fair value recognition provisions of the original SFAS 123, which differs from the effect of SFAS 123R, had been applied to stock compensation awards (rather than applying the intrinsic value measurement provisions of Opinion 25) are disclosed in Note 2 of the consolidated financial statements.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-2 (FAS 109-2), Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creations Act (AJCA) of 2004.

The AJCA introduces a limited time 85% dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. FAS 109-2 provides accounting and disclosure guidance for the repatriation provision. Although FSP 109-2 is effective immediately, the Company does not expect to be able to complete its evaluation of the

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

repatriation provision until after Congress or the Treasury Department provides additional clarifying language on key elements of the provision.

4. ACQUISITIONS

In August 2002, the Company purchased a set of two patents for $375,000. The patents are being amortized over the estimated useful life of five years. For each of the years ended December 31, 2004 and 2003, the Company amortized $75,000 annually and was included in the research and development expense of the company s consolidated statement of operations.

During 2001, the Company entered into an agreement with a third-party that gives the Company non-exclusive intellectual property rights to text to speech software code. The Company paid $7.0 million for this purchased technology, which was capitalized and is being amortized over its estimated useful life of five years. The Company amortized $1.2 million to research and development in 2001. The Company also performed an impairment analysis for the year ended December 31, 2001. The asset was impaired and was written down by $4.4 million to its estimated fair value based on estimated discounted future cash flows. For each of the years ended December 31, 2004 and 2003, the Company amortized $0.3 million annually. The agreement includes a royalty clause whereby the Company pays 5% of all net revenue attributable to sublicenses of this technology to a third-party. The term of the royalty payments is eight years. There was no royalty payment payable for the years ended December 31, 2004 and 2003.

In 2000, the Company acquired all the outstanding shares of SpeechFront, Inc. Part of the consideration included 55,295 shares of the Company common stock (16,588 shares for representations and warranties in the purchase agreement, and 38,707 shares for the SpeechFront founders retention and product milestone achievement.). This consideration was contingently payable in the purchase agreement 18 months from the acquisition date and all shares were issued in 2002.

5. CONCENTRATIONS

Credit risk with respect to accounts receivable is diversified due to the large number of entities comprising the Company s customer base and their dispersion across many different industries and geographies. The Company performs ongoing credit evaluations of its customers financial condition.

As of December 31, 2004, one customer accounted for more than 10% of the accounts receivable balance. As of December 31, 2003, three customers accounted for, individually, 13%, 12% and 12% of the accounts receivable balance.

For the year ended December 31, 2004, no customer accounted for more than 10% of total revenue; for the year ended December 31, 2003, one customer accounted for 12% of total revenue; and for the year ended December 31, 2002, one customer accounted for 10% of total revenue.

In 2004, 2003 and 2002, the Company s revenue attributable to indirect sales through third-party resellers was 53%, 58% and 74%, respectively. For each of the years ended December 31, 2004 and 2003, no third-party reseller accounted for more than 10% of total revenue; for the year ended December 31, 2002, one third-party reseller accounted for 10% of total revenue.

6. BALANCE SHEET DETAIL

In December 2004, the Company loaned $5,000,000 to Spanlink Communications, Inc. (Spanlink). The loan is evidenced by a promissory note of Spanlink, bearing interest at 2.45% per annum, with principal and all accrued interest payable in June 2007 (the Note). The obligations of Spanlink under the Note are collateralized by a security interest in all of Spanlink s assets. The Company s rights under the security interest are subordinated to certain other debt of Spanlink, including senior indebtedness up to a specified dollar amount. The amounts outstanding under the Note are convertible into Spanlink stock in certain circumstances. As of

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2004, the unpaid principal amount, together with accrued interest, aggregated $5,005,000. Each quarter thereafter, the Company will review the Spanlink loan for possible impairment.

Property and Equipment

	December 31,	
	2004	2003
	(In thousands)	
Computer equipment and software	$ 19,259	$ 16,941
Leasehold improvements	1,879	1,619
Furniture and fixtures	1,611	1,443
Total property and equipment	22,749	20,003
Less: Accumulated depreciation	(18,690)	(16,066)
Total	$ 4,059	$ 3,937

Accrued Liabilities

	December 31,	
	2004	2003
	(In thousands)	
Accrued compensation	$ 2,347	$ 2,604
Accrued vacation	1,495	1,513
Accrued expenses	2,586	1,870
Deferred income taxes and income tax payable	427	547
Other accrued liabilities	1,212	386
Total	$ 8,067	$ 6,920

7. INVESTMENTS

The Company classifies investment securities based on management s intention on the date of purchase and reevaluates such designation as of each balance sheet date. Securities are classified as available-for-sale and carried at fair value, which is determined based on quoted market prices, with net unrealized gains and losses included in Accumulated other comprehensive income (loss) in the accompanying consolidated balance sheet.

The components of the Company s marketable securities were as follows (in thousands):

Investment Type	Cost	As of December 31, 2004 Unrealized Gains	Unrealized Losses	Fair Value
U.S. government notes and bonds	$ 17,499	$	$ (39)	$ 17,460
Corporate bonds	15,620		(73)	15,547
Marketable securities	4,487		(1)	4,486
Total	$ 37,606	$	$ (113)*	$ 37,493
Short-term investments				$ 37,493
Long-term investments				
Total				$ 37,493

* As of December 31, 2004, $113,000 unrealized loss was for investments held less than 12 months.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	As of December 31, 2003			
Investment Type	**Cost**	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
U.S. government notes and bonds	$ 41,683	$ 15	$ (2)	$ 41,696
Corporate bonds	16,586		(9)	16,577
Marketable securities	8,325	1		8,326
Total	$ 66,594	$ 16	$ (11)	$ 66,599
Short-term investments				$ 66,599
Long-term investments				
Total				$ 66,599

The Company s investments will mature as follows (in thousands):

	As of December 31, 2004	
Investment Type	**Maturity Less than 1 year**	**Total Fair Value**
Government agency bonds	$ 17,460	$ 17,460
Corporate bonds	15,547	15,547
Marketable Securities	4,486	4,486
Total	$ 37,493	$ 37,493

8. INTANGIBLE ASSETS

Information regarding the Company s intangible assets follows (in thousands):

	As of December 31, 2004			
	Gross Amount	**Accumulated Amortization**	**Net**	**Remaining Life**
Patents Purchased	$ 375	$ (175)	$ 200	33 months
Purchased Technology	2,618	(2,238)	380	14 months

Total	$ 2,993	$ (2,413)	$ 580

	As of December 31, 2003			
	Gross Amount	**Accumulated Amortization**	**Net**	**Remaining Life**
Patents Purchased	$ 375	$ (100)	$ 275	45 months
Purchased Technology	2,618	(1,900)	718	26 months
Total	$ 2,993	$ (2,000)	$ 993	

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The total estimated amortization of the Patents Purchased and Purchased technology for each of the three fiscal years subsequent to December 31, 2004 is as follows (in thousands):

Year Ended December 31,		Amortization Expense
2005		413
2006		117
2007		50
Total	$	580

9. GUARANTEES

Guarantees

As of December 31, 2004, the Company s financial guarantees consist of standby letters of credit outstanding, representing the restricted cash requirements collateralizing the Company s lease obligations. The maximum amount of potential future payment under the arrangement at December 31, 2004 were $10.9 million related to the Company s Pacific Shores lease in California and $201,000 related to the Company s Montreal lease, totaling $11.1 million presented as restricted cash on the Company s consolidated balance sheets at December 31, 2004.

Warranty

The Company does not maintain a general warranty reserve for estimated costs of product warranties at the time revenue is recognized due to the effectiveness of its extensive product quality program and processes.

Indemnifications to Customers

The Company defends and indemnifies its customers for damages and reasonable costs incurred in any suit or claim brought against them alleging that the Company s products sold to its customers infringe any U.S. patent, copyright, trade secret or similar right. If a product becomes the subject of an infringement claim, the Company may, at its option: (i) replace the product with another non-infringing product that provides substantially similar performance; (ii) modify the infringing product so that it no longer infringes but remains functionally equivalent; (iii) obtain the right for the customer to continue using the product at the Company s expense and for the third-party reseller to continue selling the product; (iv) take back the infringing product and refund to customer the purchase price paid less depreciation amortized on a straight line basis. The Company has not been required to make material payments pursuant to these provisions historically. The Company has not identified any losses that are probable under these provisions and, accordingly, the Company has not recorded a liability related to these indemnification provisions.

Indemnifications to Officers and Directors

The Company s corporate by-laws require that the Company indemnify its officers and directors, as well as those who act as directors and officers of other entities at its request, against expenses, judgments, fines, settlements and other amounts actually and reasonably incurred in connection with any proceedings arising out of their services to the Company. In addition, the Company has entered into separate indemnification agreements with each director, each board-appointed officer of the Company and certain other key employees of the Company that provides for indemnification of these directors, officers and employees under similar circumstances. The indemnification obligations are more fully described in the by-laws and the indemnification agreements. The Company purchases insurance to cover claims, or a portion of claims, made against its directors and officers. Since a maximum obligation of the Company is not explicitly stated in the Company s by-laws or in its indemnification agreements and will depend on the facts and circumstances that arise out of

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

any future claims, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, the Company has not made payments related to these obligations, and the estimated fair value for these obligations is zero on the consolidated balance sheet as of December 31, 2004.

Other Indemnifications

As is customary in the Company s industry and as provided for in local law in the U.S. and other jurisdictions, many of its standard contracts provide remedies to others with whom the Company enters into contracts, such as defense, settlement, or payment of judgment for intellectual property claims related to the use of its products. From time to time, the Company indemnifies its suppliers, contractors, lessors, lessees and others with whom the Company enters into contracts, against combinations of loss, expense, or liability arising from various trigger events related to the sale and the use of its products and services, the use of their goods and services, the use of facilities, the state of the assets and businesses that the Company sells and other matters covered by such contracts, usually up to a specified maximum amount. In addition, from time to time the Company also provides protection to these parties against claims related to undiscovered liabilities, additional product liability or environmental obligations. In the Company s experience, claims made under such indemnifications are rare and the associated estimated fair value of the liability is not material. At December 31, 2004, there were no claims for such indemnifications.

10. NET LOSS PER SHARE

The following table presents the calculation of basic and diluted net loss per share (in thousands, except per share data):

	Year Ended December 31,		
	2004	**2003**	**2002**
Net loss attributable to common stockholders	$ (26,179)	$ (19,301)	$ (71,184)
Calculation of loss per share basic and diluted:			
Weighted average shares of common stock outstanding basic and diluted	35,487	34,482	33,734
Less: Weighted average shares of common stock subject to repurchase basic and diluted		(11)	(68)
Weighted average shares used in computing net loss per share basic and diluted	35,487	34,471	33,666
Basic and diluted net loss per share	$ (0.74)	$ (0.56)	$ (2.11)

The total number of shares excluded from diluted net loss per share was 9,475,000 shares, 9,523,000 shares and 7,371,000 shares as of December 31, 2004, 2003 and 2002, respectively.

11. RESTRUCTURING CHARGES AND ASSET IMPAIRMENTS

In 2001, the Company reduced its workforce by 80 employees, with reductions ranging between 10% and 20% across all functional areas and affecting several locations. In 2002, the Company reduced its workforce by another 114 employees, primarily to realign the sales organization, to align the cost structure with changing market conditions and to create a more efficient organization. In 2003, the Company reduced its general and administrative workforce by 9%, or five employees, to further realign the organizational structure. In 2004, the Company reduced its product management and engineering workforce by 16 employees, approximately 5% of the total workforce, to lower the overall cost structure and allow the Company to hire additional sales and outbound marketing resources.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company will continue to evaluate its resource and skills requirements and, adjust its staffing appropriately, including decreasing its workforce in some areas or functions if required. The Company may also in the future be required to increase its workforce to respond to changes or growth in its business, and as a result may need to expand its operational and human resources, as well as its information systems and controls, to support any such growth. Such expansion may place significant demands on the Company s management and operational resources.

In connection with the 2001 reduction in workforce plan, the Company decided not to occupy its Pacific Shores facility. This decision resulted in a lease loss of $32.6 million for the year ended December 31, 2001, comprised of sublease loss, broker commissions and other facility costs. To determine the sublease loss, the loss after the Company s cost recovery efforts to sublease the building, certain assumptions were made relating to the (1) time period over which the building will remain vacant, (2) sublease terms and (3) sublease rates. The Company established the reserves at the low end of the range of estimable cost against outstanding commitments, net of estimated future sublease income. These estimates were derived using the guidance provided in SAB No. 100, Restructuring and Impairment Charges, and EITF No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring). The lease loss was increased in August 2002, September 2003 and September 2004, as described below and will continue to be adjusted in the future upon triggering events (change in estimate of time to sublease, actual sublease rates, or other factors as these changes become known).

Fiscal Year 2002

In January 2002, with the approval of its Board of Directors, the Company implemented a restructuring plan to reduce its workforce. The restructuring was primarily to realign the sales and professional services structure. The Company recorded a restructuring charge of $1.3 million during the three months ended March 31, 2002, consisting primarily of payroll and related expenses associated with reducing headcount. This amount was paid out as of December 31, 2002.

In August 2002, with the approval of its Board of Directors, the Company implemented a restructuring plan to reduce its worldwide workforce to realign its expense structure with near term market opportunities. In connection with the reduction of workforce, the Company recorded a charge of $2.6 million primarily for severance and related employee termination costs. It was fully paid off as of December 31, 2003. For the third quarter 2003, it also reversed an excess accrual for this restructuring plan, which resulted in the recording of $0.2 million as a credit to the restructuring charge line.

The restructuring plan also included the consolidation of facilities through the closing of certain international offices that resulted in a charge of $0.7 million, which was fully paid out during the first quarter of 2004.

In addition, in fiscal year 2002, the Company recorded an increase in its previously reported real estate restructuring accrual related to its unoccupied leased facility. This additional charge of $31.8 million resulted from an analysis of the time period during which the California property is likely to remain vacant and prospective sub-lease terms and sub-lease rates.

Fiscal Year 2003

During the third quarter of 2003, with the approval of its Board of Directors, the Company implemented a restructuring plan to reduce its general and administrative workforce to realign the organizational structure. The

Company recorded a restructuring charge of $0.2 million primarily for severance and termination costs relating to the reduction in workforce. As of December 31, 2003, all severance payments were fully paid. In addition, the Company revised the estimate for the August 2002 restructuring plan, which resulted in a $0.2 million credit to the restructuring expense.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the third quarter of 2003, Company reviewed the earlier estimate for the lease loss for its unoccupied leased facility and the condition of the San Francisco Bay Area commercial real estate market. The Company estimated that it might take an additional 18 months to sublease this unoccupied facility. The Company also reduced the estimates for the expected sublease rates. This evaluation resulted in recording an additional lease loss of $10.4 million, which was recorded as part of the restructuring expense.

Fiscal Year 2004

In September 2004, with the approval of its Board of Directors, the Company reduced its headcount in engineering, product management by 16 employees, to lower its overall cost structure and to allow the Company to reallocate resources to its sales operations and outbound marketing efforts. This resulted in a severance charge of $574,000 recorded as restructuring expense on the consolidated statement of operations.

In September 2004, the Company reviewed its earlier estimate for its unoccupied leased facility and the condition of the San Francisco Bay Area real estate market. The Company estimated that it might take an additional 18 months to sublease this unoccupied facility. The Company also lowered the estimates for the expected sublease rates due to the condition of San Francisco Bay Area real estate market. This evaluation resulted in recording an additional lease loss of $19.2 million, which was recorded as restructuring expense on the consolidated statement of operations.

During the preparation of the Company s consolidated financial statements for the three and nine months ended September 30, 2004, the Company discovered that an immaterial mathematical error had been made in the third quarter 2003 revaluation of the restructuring accrual calculation for the unoccupied leased facility. The Company increased the third quarter 2004 restructuring accrual by $748,000 to adjust for this error, included in the $19.2 million mentioned in the preceding paragraph.

As of December 31, 2004, the Company expects the remaining future net cash outlay under the restructuring plans for its unoccupied lease facility to be $62.9 million, of which $10.2 million of the lease loss is to be paid out over the next 12 months and $52.7 million is to be paid out over the remaining life of the lease of approximately eight years.

As noted, the Company has recorded a lease loss related to future lease commitments for its unoccupied lease facility, net of estimated sublease income. However, given the condition of the San Francisco Bay Area commercial real estate market, the Company may be required to periodically reevaluate the components of the estimated sublease income, because such components affect the estimated lease loss for the unoccupied leased facility. Specifically, the Company is required to reevaluate the time that it might take to sublease this unoccupied facility, as well as the expected sublease rates. This evaluation may result in additional lease loss of up to approximately $22 million if the facility is not subleased at any time during the balance of the term of the related lease, which would increase the restructuring charges by the amount of that loss.

The restructuring charges and balance are as follows (in thousands):

	Lease	Severance and	Asset Write	Total

	Loss	Related	Down	Restructuring
Balance at December 31, 2001	$ 29,043	$ 100	$	$ 29,143
Total charges for the year ending December 31, 2002	31,829		$	31,829
Amount utilized in the year ended December 31, 2002	(9,342)	(100)		(9,442)
Balance at December 31, 2002	$ 51,530	$	$	$ 51,530
Total charges for the year ending December 31, 2003	$ 11,316	$	$ (943)	$ 10,373
Amount utilized in the year ending December 31, 2003	(10,477)		943	(9,534)
Balance at December 31, 2003	$ 52,369			$ 52,369

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Lease Loss	Severance and Related	Asset Write Down	Total Restructuring
As of December 31, 2003:				
Current restructuring accrual	$ 9,478	$	$	$ 9,478
Long-term restructuring accrual	$ 42,891	$	$	$ 42,891
Total charges for the year ended December 31, 2004	$ 19,223	$	$	$ 19,223
Amount utilized in the year ended December 31, 2004	(8,765)			(8,765)
Balance at December 31, 2004	$ 62,827			$ 62,827
As of December 31, 2004:				
Current restructuring accrual	$ 10,122	$	$	$ 10,122
Long-term restructuring accrual	$ 52,705	$	$	$ 52,705
2002 Plan				
Balance at December 31, 2003	$ 35	$	$	$ 35
As of December 31, 2003:				
Current restructuring accrual	$ 35	$	$	$ 35
Total charges for the year ended December 31, 2004				
Amount utilized in the year ended December 31, 2004	(35)			(35)
Balance at December 31, 2004	$			$
2003 Plan				
Balance at December 31, 2003	$	$ 41	$	$ 41
As of December 31, 2003:				
Current restructuring accrual	$	$ 41	$	$ 41
Total charges for the year ended December 31, 2004				
Amount utilized in the year ended December 31, 2004		(41)		(41)
Balance at December 31, 2004	$			$
2004 Plan				
Total charges for the year ended December 31, 2004		558		558
Amount utilized in the year ended December 31, 2004		(477)		(477)
Balance at December 31, 2004	$	81		81

Summary for balance at December 31, 2003 (All restructuring plans)								
Restructuring accrual: Current	$	9,513	$	41	$		$	9,554
Restructuring accrual: Long-term	$	42,891	$		$		$	42,891
Summary for balance at December 31, 2004								
Restructuring accrual: Current	$	10,122	$	81	$		$	10,203
Restructuring accrual: Long-term	$	52,705	$		$		$	52,705

Asset impairments

In February 2003, the Company received cash and recorded an asset impairment credit of $0.9 million related to a refund of tenant improvement costs for the building the Company did not occupy, following the

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

landlord s reconciliation of tenant improvement costs. This credit was recorded in restructuring charges and asset impairments in the consolidated statements of operations.

In 2002, in connection with the August 2002 restructuring plan, the Company wrote off certain fixed assets as a result of consolidating and closing of certain international offices and recorded an asset impairment charge of $0.9 million.

12. COMMITMENTS AND CONTINGENCIES

Operating leases

In May 2000, the Company entered into a lease for its Pacific Shore facility. The lease has an eleven-year term, which began in August 2001. A $10.9 million certificate of deposit secures a letter of credit required by the landlord for a rent deposit. In conjunction with the April 2001 restructuring plans, the Company decided not to occupy this leased facility. In 2004, the Company reviewed its earlier estimate for the unoccupied leased facility and the condition of the San Francisco Bay Area real estate market and estimated that it might take an additional 18 months to sublease this unoccupied facility. The Company also lowered the estimates for the expected sublease rates due to the condition of San Francisco Bay Area real estate market. This evaluation resulted in recording an additional lease loss of $19.2 million in 2004. The future minimum lease payments table referenced below does not include estimated sublease income, as there are no sublease commitments as of December 31, 2004.

In June 2004, the Company signed lease agreements for three office buildings in the Menlo Park location, under which the Company leases an aggregate of approximately 49,000 square feet. Each of the leases has a five-year term, expiring in August 2009 without renewal options. The initial aggregate monthly cash payment for these three leases totals approximately $42,000.

The Company leases its facilities under non-cancelable operating leases with various expiration dates through July 2012. Rent expense is recognized on a straight-line basis over the lease term for leases that have scheduled rental payment increases. Rent expense for the years ended December 31, 2004, 2003 and 2002 was approximately $1.9 million, $2.2 million and $2.7 million, respectively.

As of December 31, 2004, future minimum lease payments under these agreements (excluding sublease income), including the Company s unoccupied leased facility and lease loss portion of the restructuring charges, are as follows (in thousands):

Fiscal Year Ending December 31,	**Operating Leases**
2005	$ 9,337
2006	9,299
2007	9,505
2008	9,535
2009	9,648
Thereafter	25,500

Total future minimum lease payments	$	72,824

Employment Agreements

In April 2003, the Company entered into an employment agreement with its President and Chief Executive Officer. This employment agreement provides for annual base salary compensation, variable compensation, stock option grants, and stock option acceleration and severance payments in the event of termination of employment under certain defined circumstances or upon a change in control of the Company.

FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Variable and equity compensation are subject to adjustments based on the Company s financial performance and other factors. The agreement has been extended, according to its terms, until April 2006.

Legal

In April 2004, the Company was served with a civil complaint filed by Voice Capture, Inc. in the United States District Court for the Southern District of Iowa (the Complaint). The Complaint, which names as defendants the Company, Intel Corporation and Dialogic Corporation, alleges that certain software and services of the defendants infringe upon certain claims contained in U.S. Patent No. Re 34,587 (Interactive Computerized Communications Systems with Voice Input and Output). In January 2005, the Company settled the case for an amount that is less than half of the projected legal fees and cost to defend the case through trial. This amount was recorded in the General and Administrative line of the Consolidated Statements of Operations. As a result of the settlement, the case has been dismissed with prejudice and the plaintiff has released all claims it may have against the Company.

In August 2001, the first of a number of complaints was filed, in the United States District Court for the Southern District of New York, on behalf of a purported class of persons who purchased the Company s stock between April 12, 2000, and December 6, 2000. Those complaints have been consolidated into one action. The complaint generally alleges that various investment bank underwriters engaged in improper and undisclosed activities related to the allocation of shares in the Company s initial public offering of securities. The complaint makes claims for violation of several provisions of the federal securities laws against those underwriters, and also against the Company and some of the Company s directors and officers. Similar lawsuits, concerning more than 250 other companies initial public offerings, were filed in 2001. In February 2003, the Court denied a motion to dismiss with respect to the claims against the Company. In the third quarter of 2003, a proposed settlement in principle was reached among the plaintiffs, issuer defendants (including the Company) and the issuers insurance carriers. The settlement calls for the dismissal and release of claims against the issuer defendants, including the Company, in exchange for a contingent payment to be paid, if necessary, by the issuer defendants insurance carriers and an assignment of certain claims. The timing of the conclusion of the settlement remains unclear, and the settlement is subject to a number of conditions, including approval of the Court. The settlement is not expected to have any material impact upon us, as payments, if any, are expected to be made by insurance carriers, rather than by the Company. In July 2004, the underwriters filed a motion opposing approval by the court of the settlement among the plaintiffs, issuers and insurers. In March 2005, the court granted preliminary approval of the settlement, subject to the parties agreeing to modify the term of the settlement which limits each underwriter from seeking contribution against its issuer for damages it may be forced to pay in the action. In the event a settlement is not concluded, the company intends to defend the litigation vigorously. The Company believes it has meritorious defenses to the claims against the Company.

In addition, the Company is subject, from time to time, to various other legal proceedings, claims and litigation that arise in the normal course of business. While the outcome of any of these matters is currently not determinable, management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on the Company s consolidated financial position, results of operations or cash flows.

13. STOCKHOLDERS EQUITY

Stock Purchase Rights

In December 2002, the Board of Directors approved a Stock Purchase Rights Plan, which declared a dividend distribution of one Preferred Stock Purchase Right for each outstanding share of Common Stock, $0.001 par value, of the Company. The distribution was paid, as of January 3, 2003, to stockholders of record on that date. Each Right entitles the registered holder to purchase from the Company one one-thousandth of a share of its Series A Preferred Stock, $0.001 par value, at a price of $22.00 per share.

FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Warrant GM Onstar

In December, 2000, the Company issued to GM OnStar, a customer, a warrant to purchase 100,000 shares of common stock at an exercise price of $138.50 per share, subject to certain anti-dilution adjustments. The warrant was exercisable at the option of the holder, in whole or part, at any time between January 17, 2001 and August 2002. In January 2001, the Company valued the warrant at $0.5 million, utilizing the Black-Scholes valuation model, using the following assumptions; risk-free interest rate of 5.5%, expected dividend yields of zero, expected life of 1.5 years, and expected volatility of 80%. The Company amortized $0.2 million and $0.3 million related to this warrant in 2002 and 2001, respectively. The warrant was fully amortized and expired unexercised in August 2002.

1994 and 1998 Stock Option Plans

On September 1, 2000, the 1994 Flexible Stock Incentive Plan was terminated. Upon termination of the plan, all unissued options were cancelled.

In August 1998, the Board of Directors approved the 1998 Stock Plan, which terminated upon the Company s initial public offering In April, 2000. As a result of the termination, the shares remaining available for grant under the 1998 Stock Plan were transferred to the Company s 2000 Stock Plan. Options issued under the 1998 Stock Plan have a term of ten years from the date of grant and generally vest 25% after one year, then ratably on a monthly basis over the succeeding three years. Due to the termination of the 1998 Stock Plan, options issued to employees under that plan that expire or become unexercisable will not be available for future distribution under the 2000 Stock Plans.

2000 Stock Plan

In February 2000, the Board of Directors and stockholders approved the 2000 Stock Plan. The 2000 Stock Plan, which became effective as of the Company s initial public offering in April, 2000, assumed the remaining shares reserved under the 1998 Stock Plan. Accordingly, no future grants will be made under the 1998 Stock Plan. Under the 2000 Stock Plan, the Board of Directors may grant options to purchase the Company s common stock to employees, directors, or consultants at an exercise price of not less than 100% of the fair value of the Company s common stock at the date of grant, as determined by the Board of Directors. The 2000 Stock plan will terminate automatically in January 2010, unless terminated earlier by the Company s Board of Directors. Options issued under the 2000 Stock Plan have a term of ten years from the date of grant and vest 25% after one year, then ratably on a monthly basis over the succeeding three years. Pursuant to the terms of the 2000 stock plan, the number of shares reserved under the 2000 stock plan will automatically be increased each year, beginning on January 1, 2001, in an amount equal to the lesser of (a) 4,000,000 shares, (b) 6% of the Company s shares outstanding on the last day of the preceding fiscal year, or (c) a lesser amount determined by the Board of Directors. The plan was increased by 2,099,715 shares, 2,050,934 shares and 1,991,883 shares in 2004, 2003 and 2002, respectively.

2001 Non-statutory Stock Option Plan

In May 2001, the Board of Directors approved the 2001 Non-statutory Stock Option Plan. The Company reserved a total of 500,000 shares of its common stock for issuance under this plan. In November, 2002, the Board of Directors authorized an additional 850,000 shares of the Company s common stock for issuance under the plan. Under the 2001 Non-statutory Stock Option Plan, the Board of Directors may grant options to purchase the Company s common stock to employees and consultants. Options may not be granted to Officers and Directors, except in connection with an Officer s initial service to the Company. The Plan will expire by its own terms in 2011, unless terminated sooner by the Board. Options issued under the 2001 Non-statutory Stock Option Plan have a term of ten years from the date of grant and vest 25% after one year, then ratably on a monthly basis over the remaining three years.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock Option Exchange Program

On March 1, 2002, the Company filed a tender offer document with the SEC for an employee Stock Exchange Program. This was a voluntary stock option exchange program for all qualified employees. The exchange program was not available to executive officers, directors, consultants or former employees. Under the program, employees were given the opportunity to elect to cancel outstanding stock options that had an exercise price of $15.00 or greater under the 1998 Stock Plan and 2000 Stock Plan held by them in exchange for new options to be granted under the 2000 Stock Plan at a future date at the then current fair market value. The new options were to be granted no earlier than the first business day that is six months and one day after the cancellation date of the exchanged options. The exercise price per share of the new options was to be 100% of the fair market value on the date of grant, as determined by the closing price of the Company s common stock reported by NASDAQ National Market for the last market trading day prior to the date of grant. These elections were made by March 29, 2002 and were required to include all options granted during the prior six-month period. In April 1, 2002, stock options in the amount of 1,492,389 were cancelled relating to this program. On October 4, 2002, employees who participated in the stock option exchange program were granted new options under the 2000 Stock Plan with an exercise price of $1.65. There were 967,012 stock options for common stock granted relating to this program. All the stock option grants were vested at 1/8 of the shares subject to the option at the date of grant and 1/48th of the shares subject to the option shall vest each month thereafter. Under the provisions of APB No. 25 no compensation expense has been recognized in the Company s consolidated statement of operations for the issuance of the replacement options.

Employee Stock Purchase Plan

In February 2000, the Board of Directors and stockholders approved the 2000 Employee Stock Purchase Plan (the Purchase Plan). The Company reserved a total of 1,000,000 shares of common stock for issuance under this plan, which became effective as of the Company s initial public offering on April 13, 2000. The Purchase Plan is administered over offering periods of 24 months each, with each offering period divided into four consecutive six-month purchase periods beginning November 1 and May 1 of each year. Eligible employees can contribute up to 15% of their compensation each pay period for the purchase of common stock, not to exceed 2,000 shares per six-month period. On the last business day of each purchase period, shares of common stock are purchased with the employee s payroll deductions accumulated during the six months, at a purchase price per share of 85% of the market price of the common stock on the employee s entry date into the applicable offering period or the last day of the applicable offering period, whichever is lower.

The number of shares reserved under the Purchase Plan will automatically be increased each year, beginning on January 1, 2001, in an amount equal to the lesser of (a) 1,500,000 shares, (b) 2% of the Company s shares outstanding on the last day of the preceding fiscal year, or (c) any lesser amount determined by the Board of Directors. The plan increased by 699,905 shares, 683,644 shares and 663,961 shares for 2004, 2003 and 2002, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In 2004, 2003 and 2002, approximately 706,000 shares, 586,000 shares and 615,000 shares were issued under this plan, respectively, representing employee contributions of approximately $1.6 million, $1.2 million and $2.0 million, respectively. As of December 31, 2004, approximately 466,805 shares were available for issuance under the Employee Stock Purchase Plan. Option activity under the Stock Option Plans is as follows (in thousands, except per share data):

	Shares Available for Grant	Options Outstanding Number of shares	Options Outstanding Weighted Average Exercise Price
January 1, 2002 (2,330,000 shares exercisable at weighted average exercise price of $24.32 per share)	459	8,181	$ 26.07
Authorized	2,842		
Options granted (weighted average fair value of $2.24 per share)	(3,180)	3,180	2.99
Options exercised		(307)	1.62
Options cancelled	3,683	(3,683)	41.47
Options terminated	(906)		9.86
December 31, 2002 (2,895,000 shares exercisable at weighted average exercise price of $12.80 per share)	2,898	7,371	$ 9.35
Authorized	2,051		
Options granted (weighted average fair value of $2.69 per share)	(3,233)	3,233	3.51
Options exercised		(228)	2.99
Options cancelled	853	(853)	17.96
Options terminated	(127)		10.53
December 31, 2003 (4,573,000 shares exercisable at weighted average exercise price of $9.07 per share)	2,442	9,523	$ 6.75
Authorized			
Options granted (weighted average fair value of $4.10 per share)	(1,996)	1,996	5.31
Options exercised		(377)	2.41
Options cancelled	1,667	(1,667)	9.04
Options terminated	(419)		10.48
December 31, 2004 (5,545,000 shares exercisable at weighted average exercise price of $7.44 per share)	1,694	9,475	$ 6.22

As of December 31, 2004, the Company had reserved 11,636,000 shares of its common stock for future issuance.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the stock options outstanding and exercisable as of December 31, 2004:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices (In $)	**Number of Shares (In thousands)**	**Weighted Average Remaining Contract Life (In years)**	**Weighted Average Exercise Price (In $)**	**Number Exercisable (In thousands)**	**Weighted Average Exercise Price (In $)**
$ 0.0 - 5.0	5,324	8.0	$ 3.03	2,335	$ 2.58
5.0 - 10.0	2,797	6.5	7.91	1,970	8.09
10.0 - 13.0	760	6.2	11.80	651	11.80
13.0 - 17.0	514	5.2	14.92	509	14.93
17.0 - 35.0	39	5.7	31.71	39	31.70
35.0 - 52.5	16	6.0	38.59	16	38.59
52.5 - 70.0	11	5.9	59.48	11	59.48
70.0 - 105.0	5	5.8	89.00	5	89.00
105.0 - 122.5	9	5.7	112.52	9	112.52
	9,475	7.2	$ 6.22	5,545	$ 7.44

The following table summarizes the detailed information for each plan:

	1994 Option Plan	**1998 Option Plan**	**2000 Option Plan**	**2001 Option Plan**	**All Option Plans Total**	**Employee Stock Purchase Plan**
Number of shares to be issued upon the exercise of outstanding options	79,376	1,768,824	6,400,049	1,227,228	9,475,477	2,523,977
Weighted average exercise price of the outstanding options	$ 1.18	$ 9.83	$ 5.81	$ 3.48	$ 6.22	$ 3.78
			1,583,761	110,513	1,694,274	466,805

Number of shares
available for future
issuance

Deferred Stock Compensation

The Company accounts for its stock-based awards to employees using the intrinsic value method in accordance with APB No. 25. Accordingly, the Company records deferred stock compensation equal to the difference between the grant price and fair value of the Company s common stock on the date of grant. In connection with the grant of stock options prior to the Company s initial public offering, the Company recorded deferred stock compensation of approximately $8.7 million within stockholders equity, representing the difference between the estimated fair value of the common stock for accounting purposes and the option exercise price of these options at the date of grant. This amount was presented as a reduction of stockholders equity and being amortized over the vesting period of the applicable options. Relating to approximately 3,152,000 stock options granted before initial public offering at a weighted average exercise price of $8.58, for the years ended December 31, 2003 and 2002, the Company recorded amortization of deferred compensation of $0.2 million and $0.9 million. During the same periods, the Company reversed excess amortization of deferred stock compensation due to termination of employees of ($0.2) million and ($0.4) million, resulting in no net expense for deferred compensation and $0.5 million, respectively. For the year ended December 31, 2002, the Company reversed approximately $0.1 million of deferred stock compensation into additional paid-in capital, representing unamortized deferred stock compensation relating to forfeitures of stock options by terminated employees. Deferred stock-based compensation was fully amortized as of December 31, 2003.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In 2000, the Company acquired all the outstanding shares of SpeechFront, Inc. Part of the consideration included 55,295 shares of the Company common stock (16,588 shares for representations and warranties in the purchase agreement, and 38,707 shares for the SpeechFront founders retention and product milestone achievement). This consideration was contingently payable in the purchase agreement 18 months from the acquisition date and was issued in 2002. In connection with the SpeechFront acquisition, the Company recorded deferred compensation expense $0.4 million for the year ended December 31, 2002. SpeechFront related deferred compensation was fully amortized as of December 31, 2002.

SFAS No. 123 Fair Value Disclosures

Since the Company continues to account for its stock-based awards to employees using the intrinsic value method in accordance with APB No. 25, SFAS No. 123 requires the disclosure of pro forma net income (loss) as if the Company had adopted the fair value method. Under SFAS No. 123, the fair value of stock-based awards is calculated through the use of option pricing models, even though such models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company s stock option awards. The Company s calculations were made using the Black-Scholes option pricing model, which requires subjective assumptions, including expected time to exercise, which greatly affects the calculated values and the resulting pro forma compensation cost may not be representative of that to be expected in future periods. The Company amortizes the fair value of stock options on a straight-line basis over the required periods.

The following weighted average assumptions were used in the estimated grant date fair value calculation for the Company stock option awards:

	Stock Options Year Ended December 31,			Employee Stock Purchase Plan Year Ended December 31,		
	2004	2003	2002	2004	2003	2002
Risk-free interest rate	2.73 - 3.85%	2.37 - 3.27%	2.4%	1.17 - 2.20%	1.02 -1.15%	1.23 - 1.91%
Expected dividend yield						
Expected life of option (in years)	4.66 - 5.13	4.63 - 5.1	4.06	0.5	0.5	0.5
Volatility	102.4 - 108.0%	102.3 - 104.9%	111.06%	37.60 - 46.94%	44.72 -51.67%	53.26 - 78.26%

Under the above Black-Scholes option valuation model assumptions, The weighted average fair value of stock options granted during 2004, 2003 and 2002 was $4.10, $2.69 and $2.24, respectively. The fair value of each option grant was estimated on the date of grant.

The weighted average fair value of purchase rights granted pursuant to the Employee Stock Purchase Plan was $2.53, $3.79 and $0.98 for the year 2004, 2003 and 2002, respectively.

14. 401(k) PLAN

The Company has a defined contribution savings plan under Section 401(k) of the Internal Revenue Code. The plan provides for tax-deferred salary deductions and after-tax employee contributions. The Company does not make contributions to the plan.

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

15. INCOME TAXES

The total provision for (benefit from) income taxes consists of the following components (in thousands):

	2004	2003	2002
Current			
State	$ 17	$ 16	$ 114
Foreign	(500)	(1,451)	827
Total	(483)	(1,435)	941
Deferred			
Foreign	68	(371)	(141)
Total provision	$ (415)	$ (1,806)	$ 800

The components of the net deferred income tax asset as of December 31 were as follows (in thousands):

	2004	2003
Deferred tax assets		
Net operating loss carry forwards	$ 77,809	$ 73,883
Tax credit carry forwards	5,078	4,069
Capital loss carry forwards foreign	2,546	2,370
Asset impairment on purchased technology	1,975	2,115
Deferred revenue	212	463
Accrued restructuring charges	29,830	27,996
Accruals and reserves	3,811	2,525
Gross deferred tax asset	121,260	113,421
Valuation allowance	(121,212)	(113,304)
Net deferred tax asset	$ 48	$ 117

As of December 31, 2004, 2003, and 2002, the net deferred tax asset consists of foreign subsidiary temporary differences on accruals and reserves. Net deferred tax asset $48,000 is included in the Consolidated Balance Sheet in two lines, Deferred income taxes , and Accrued liabilities lines.

As of December 31, 2004, the Company has cumulative net operating loss carry forwards for federal and California income tax reporting purposes of approximately $204.2 million and $62.1 million respectively. The federal net operating loss carry forwards expire through December 2024 and the California net operating loss carry forwards expire through December 2014. In addition, the Company has carry forwards of research and experimentation tax credits for federal and California income tax purposes of approximately $3.0 million and $3.2 million, respectively, as of December 31, 2004. The federal research and experimentation tax credits expire through December 2024. The state research and experimentation credits can be carried forward indefinitely. Under current tax law, net operating loss carry forwards available in any given year may be limited upon the occurrence of certain events, including significant changes in ownership interest of the Company resulting from significant stock transactions.

The Company s income taxes payable for federal and state purposes has been reduced, and the deferred tax assets increased, by the tax benefits associated with taxable dispositions of employee stock options. When an employee exercises a stock option issued under a nonqualified plan or has a disqualifying disposition related to a qualified plan, the Company receives an income tax benefit calculated as the difference between the fair market value of the stock issued at the time of the exercise and the option price, tax effected. A

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

portion of the valuation allowance relates to the equity benefit of our net operating losses. The Company had approximately $1.1 million and $1.2 million of taxable dispositions of employee stock options for the years ended December 31, 2004 and 2003, respectively. A portion of the valuation allowance, when reduced, will be credited directly to stockholders equity.

The Company recorded a tax benefit of $0.4 million for state and foreign taxes for the year ended December 31, 2004, of which $0.3 million resulted from the reversal of all accruals and a refund related to tax assessments and penalties from the France Tax Authorities for the years ended December 31, 2001, 2000, and 1999, thereby settling all claims for those years. In addition, the Company recorded a tax benefit of $0.6 million due to the recognition of research and development tax credits from the Company s Canadian operations. For the year ended December 31, 2003, the Company recorded a tax benefit of $1.8 million for state and foreign taxes, of which $1.4 million resulted from the reversal of a prior year accrual related to tax assessments and penalties from the France Tax Authorities for the tax years listed above. In addition, the Company recorded a tax benefit of $0.6 million due to the recognition of research and development tax credits from the Company s Canadian operations.

Income (loss) before provision for income taxes consisted of (in thousands):

	December 31,		
	2004	**2003**	**2002**
United States	$ (26,779)	$ (20,727)	$ (70,935)
Foreign	185	(380)	551
Total	$ (26,594)	$ (21,107)	$ (70,384)

The actual provision for income taxes differs from the statutory U.S. federal income tax rate as follows (in thousands):

	December 31,		
	2004	**2003**	**2002**
Provision at U.S. statutory rate of 35%	$ (9,308)	$ (7,388)	$ (24,634)
State income taxes, net of federal benefit	(854)	(856)	(3,327)
Change in valuation allowance	11,551*	6,259	28,791
Effect of foreign income tax at various rates	(497)	(1,690)	497
Research and development tax credit		25	(821)
Deferred stock compensation		1,532	261
Other	(1,307)	312	33
Total	$ (415)	$ (1,806)	$ 800

* The change in valuation allowance of $11,551 does not agree to the increase in the current year valuation allowance compared to the prior year as a result of management s revised estimate of the effective state tax rates and apportionment factors.

16. SEGMENT REPORTING

The Company s operating segments are defined as components of the Company about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Company s chief operating decision maker is the Chief Executive Officer of the Company.

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company derives revenues from three primary sources: (1) license; (2) service; and (3) maintenance. Revenue and cost of revenue for the segments are identical to those presented on the accompanying consolidated statement of operations. The Company does not track expenses nor derive profit or loss based on these segments.

Sales of licenses, as well as services and maintenance through December 31, 2004, occurred through third-party resellers and through direct sales representatives located in the Company s headquarters in Menlo Park, California, and in other locations. These sales were supported through the Menlo Park location. The Company does not separately report costs by region internally.

Revenues are based on the country in which the end-user is located. The following is a summary of license, service and maintenance revenue by geographic region (in thousands):

	Year Ended December 31,		
	2004	**2003**	**2002**
License Revenue			
United States	$ 19,393	$ 17,399	$ 16,951
Canada	1,011	5,319	2,267
Europe	3,517	3,084	3,491
Asia Pacific	2,270	2,217	2,017
Latin America	218	188	2,057
Total	$ 26,409	$ 28,207	$ 26,783
Service Revenue			
United States	$ 7,566	$ 7,934	$ 5,877
Canada	5,967	5,118	1,043
Europe	1,475	889	633
Asia Pacific	707	269	181
Latin America	91	56	457
Total	$ 15,806	$ 14,266	$ 8,191
Maintenance Revenue			
United States	$ 9,910	$ 7,965	$ 5,637
Canada	1,405	1,136	659
Europe	2,151	1,794	1,319
Asia Pacific	1,565	1,098	1,000
Latin America	631	572	496
Total	$ 15,662	$ 12,565	$ 9,111

Total Revenue			
United States	$ 36,869	$ 33,298	$ 28,465
Canada	8,383	11,573	3,969
Europe	7,143	5,767	5,443
Asia Pacific	4,542	3,584	3,198
Latin America	940	816	3,010
Total Revenue	$ 57,877	$ 55,038	$ 44,085

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FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Total long-lived assets by international locations as of December 31 are as follows (in thousands):

	2004	2003
Long-Lived Assets:		
Property and equipment, net:		
United States	$ 2,932	$ 2,566
Europe	42	33
Asia Pacific	41	66
Canada	1,039	1,270
Latin America	5	2
Total	4,059	3,937
Intangible Assets:		
United States	580	993
Total	580	993
Other Long Term Assets:		
United States	16,549	11,384
Canada	201	198
Total	16,750	11,582
Total Long-Lived Assets	$ 21,389	$ 16,512

17. RELATED PARTIES

Certain members of the Company s Board of Directors also serve as directors for companies to which the Company sells products in the ordinary course of its business. The Company believes that the terms of its transactions with those companies are no less favorable to the Company than the terms that would have been obtained absent those relationships.

Specifically, 1) through 2004, one former member of the Company s Board of Directors was an officer of MCI, one of the Company s customers, 2) one member of the Company s Board of Directors is on the Board of Directors of Wells Fargo, which is a customer of the Company, and 3) one reseller, EPOS, is a wholly owned subsidiary of Tier Technologies, for which the Company s President and CEO Charles W. Berger serves as a director.

Following table summarizes the accounts receivable from these three customers as of December 31, 2004 and 2003, respectively, (in thousands).

Year Ended

	December 31, 2004	December 31, 2003
MCI	$ 303	$ 68
Wells Fargo	43	309
EPOS	94	
Total	$ 440	$ 377

FORMER NUANCE COMMUNICATIONS, INC. & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Following table summarizes the revenue generated from these three customers for the years ended December 31, 2004, 2003 and 2002, respectively, (in thousands).

	Year Ended December 31,		
	2004	**2003**	**2002**
MCI	$ 2,288	$ 2,989	$ 269
Wells Fargo	306	840	75
EPOS	599	104	44
Total	$ 3,193	$ 3,933	$ 388

18. SUPPLEMENTARY DATA: QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

Summarized quarterly financial information is as follows (in thousands, except per share data):

	Year 2004 Three Months Ended			
	March 31	**June 30**	**September 30**	**December 31**
Net revenue	$ 12,702	$ 14,393	$ 14,469	$ 16,313
Gross profit	$ 9,309	$ 11,316	$ 10,941	$ 12,821
Loss from operations	$ (2,938)	$ (1,922)	$ (22,132)	$ (699)
Net loss	$ (2,607)	$ (1,596)	$ (21,569)	$ (407)
Basic and diluted net loss per share	$ (0.07)	$ (0.05)	$ (0.61)	$ (0.01)
Shares used to compute basic and diluted net loss per share	35,067	35,386	35,567	35,929

	Year 2003 Three Months Ended			
	March 31	**June 30**	**September 30**	**December 31**
Net revenue	$ 11,563	$ 12,924	$ 13,823	$ 16,728
Gross profit	$ 8,377	$ 9,685	$ 10,613	$ 13,463
Loss from operations	$ (4,805)	$ (4,495)	$ (12,739)	$ (248)
Net loss	$ (4,275)	$ (2,667)	$ (12,172)	$ (187)
Basic and diluted net loss per share	$ (0.13)	$ (0.08)	$ (0.35)	$ (0.01)
Shares used to compute basic and diluted net loss per share	34,169	34,375	34,503	34,826

19. EVENT (UNAUDITED) SUBSEQUENT TO DATE OF REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

On September 15, 2005, the Company was acquired. At the time of the acquisition, the Company was named Nuance Communications, Inc. and the acquiring company was named ScanSoft, Inc. Following the acquisition, ScanSoft, Inc. renamed itself Nuance Communications, Inc. The acquired company (originally named Nuance Communications, Inc.) is referred to herein as Former Nuance Communications, Inc.

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SCHEDULE II

FORMER NUANCE COMMUNICATIONS, INC.

SCHEDULE OF VALUATION AND QUALIFYING ACCOUNTS AT DECEMBER 31, 2004

	Balance at Begin of Period	Charged to Expenses	Deduction	Balance at End of Period
		(In thousands)		
Year ended December 31, 2002				
Allowance for Doubtful Accounts	1,312	59	(701)	670
Year ended December 31, 2003				
Allowance for Doubtful Accounts	670	343	(176)	837
Year ended December 31, 2004				
Allowance for Doubtful Accounts	837	(59)	(195)	583

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Phonetic Systems Ltd. and its Subsidiaries

Annual Financial Statements

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Kost Forer Gabbay & Kasierer
3 Aminadav St.
Tel-Aviv 67067, Israel

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the shareholders of

PHONETIC SYSTEMS LTD.

We have audited the accompanying consolidated balance sheets of Phonetic Systems Ltd. (the Company) and its subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations, shareholders equity (deficiency) and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1d. to the financial statements, the Company s recurring losses from operations and net capital deficiency raise substantial doubt about its ability to continue as a going concern. The agreement and plan of merger are described in Note 1c and management s plans are also described in Note 1d. The 2004 financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ KOST FORER GABBAY & KASIERER
KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

Tel-Aviv, Israel
January 30, 2005

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PHONETIC SYSTEMS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	Note	December 31, 2004	December 31, 2003
		U.S. dollars in thousands	
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents		$ 515	$ 8,025
Restricted cash	7f	379	
Trade receivables, net of allowance for doubtful accounts of $172 and $94 in 2004 and 2003, respectively		617	980
Other accounts receivable and prepaid expenses	3	318	186
Inventories		526	26
Total current assets		2,355	9,217
LONG-TERM LEASE DEPOSITS		61	15
SEVERANCE PAY FUND		614	486
PROPERTY AND EQUIPMENT, NET	4,7f	1,380	551
Total assets		$ 4,410	$ 10,269
LIABILITIES AND SHAREHOLDERS EQUITY (DEFICIENCY)			
CURRENT LIABILITIES:			
Capital lease obligation	7d	$ 131	$ 54
Trade payables	5	1,372	404
Deferred revenues		1,997	1,750
Other accounts payable and accrued expenses	6	1,976	1,343
Total current liabilities		5,476	3,551
LONG-TERM LIABILITIES:			
Accrued severance pay		771	595
Capital lease obligation	7d	79	4
Total long-term liabilities		850	599
COMMITMENTS AND CONTINGENT LIABILITIES	7		
SHAREHOLDERS EQUITY (DEFICIENCY):			
Share capital:	8		
Preferred shares of New Israeli Shekel (NIS) 0.01 par value Authorized:			

4,261,388 shares at December 31, 2004 and 2003; Issued and outstanding (net of treasury shares): 2,412,258 shares at December 31, 2004 and 2003 (see Note 8a for aggregate liquidation preference as of December 31, 2004)	8	8
Ordinary shares of NIS 0.01 par value Authorized: 7,338,412 shares at December 31, 2004 and 2003; Issued and outstanding: 478,480 shares at December 31, 2004 and 2003	2	2
Treasury shares: 401,346 Series D shares and 789,317 Series E shares as of December 31, 2004 and 2003	(3)	(3)
Additional paid-in capital	45,917	43,007
Deferred stock compensation	(1,016)	
Accumulated deficit	(46,824)	(36,895)
Total shareholders equity (deficiency)	(1,916)	6,119
	$ 4,410	$ 10,269

The accompanying notes are an integral part of the consolidated financial statements.

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**PHONETIC SYSTEMS LTD.
AND ITS SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF OPERATIONS

	Note	Year Ended December 31, 2004	2003	2002
		U.S. dollars in thousands		
Sales		$ 2,390	$ 2,711	$ 2,779
Maintenance		2,574	2,005	1,730
		4,964	4,716	4,509
Cost of sales and maintenance		872	801	625
Gross profit		4,092	3,915	3,884
Operating costs and expenses:				
Research and development, net	11	4,149	2,240	3,838
Sales and marketing		6,899	5,094	6,580
General and administrative		2,930	2,239	3,120
Total operating expenses		13,978	9,573	13,538
Operating loss		(9,886)	(5,658)	(9,654)
Financial income (expenses), net		(43)	117	830
Other income			23	2
Net loss		$ (9,929)	$ (5,518)	$ (8,822)

The accompanying notes are an integral part of the consolidated financial statements.

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PHONETIC SYSTEMS LTD.
AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (DEFICIENCY)

	Preferred Shares	Ordinary Shares	Treasury Shares	Additional Paid-In Capital	Deferred Stock Compensation	Accumulated Deficit	Total Shareholders Equity (Deficiency)
				U.S. dollars in thousands			
Balance as of January 1, 2002	$ 8	$ 2	$	$ 48,041	$	$ (22,555)	$ 25,496
Warrants granted to consultants				6			6
Exercise of stock options		*)		12			12
Net loss						(8,822)	(8,822)
Balance as of December 31, 2002	8	2		48,059		(31,377)	16,692
Purchase of treasury shares			(3)	(5,060)			(5,063)
Warrants granted to consultants				4			4
Exercise of stock options		*)		4			4
Net loss						(5,518)	(5,518)
Balance as of December 31, 2003	8	2	(3)	43,007		(36,895)	6,119
Warrants granted to consultants				146			146
Deferred stock compensation				2,764	(2,764)		
Amortization of deferred stock compensation					1,748		1,748
Net loss						(9,929)	(9,929)
Balance as of December 31, 2004	$ 8	$ 2	$ (3)	$ 45,917	$ (1,016)	$ (46,824)	$ (1,916)

*) Represents an amount lower than $1.

The accompanying notes are an integral part of the consolidated financial statements.

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PHONETIC SYSTEMS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31, 2004	2003	2002
	U.S. dollars in thousands		
Cash flows from operating activities:			
Net loss	$ (9,929)	$ (5,518)	$ (8,822)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	453	770	1,178
Gain on sale of property and equipment		(1)	(2)
Accrued severance pay, net	48	2	(34)
Decrease (increase) in trade receivables	363	(452)	602
Decrease (increase) in other accounts receivable and prepaid expenses	(132)	(54)	168
Decrease (increase) in inventories	(500)	5	(28)
Increase (decrease) in trade payables	968	163	(452)
Increase (decrease) in other accounts payable and deferred revenues	880	990	(362)
Compensation expense on warrants granted to consultants	146	4	6
Amortization of deferred stock compensation	1,748		
Net cash used in operating activities	(5,955)	(4,091)	(7,746)
Cash flows from investing activities:			
Restricted cash	(379)		
Long-term deposit	(46)	64	
Proceeds from sale of property and equipment		1	107
Purchase of property and equipment	(985)	(72)	(285)
Net cash used in investing activities	(1,410)	(7)	(178)
Cash flows from financing activities:			
Proceeds from exercise of stock options		4	12
Purchase of treasury shares		(5,063)	
Payment of capital lease obligation	(145)	(88)	(79)
Net cash used in financing activities	(145)	(5,147)	(67)
Decrease in cash and cash equivalents	(7,510)	(9,245)	(7,991)
Cash and cash equivalents at the beginning of the year	8,025	17,270	25,261
Cash and cash equivalents at the end of the year	$ 515	$ 8,025	$ 17,270
Supplemental disclosure of non-cash investing and financing activities:			
Capital lease obligation related to purchase of property and equipment	$ 297	$	$ 225

The accompanying notes are an integral part of the consolidated financial statements.

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PHONETIC SYSTEMS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands

NOTE 1: GENERAL

a. Phonetic Systems Ltd. (the Company) was incorporated and commenced operations on February 7, 1994. The Company develops and markets an automatic telephone information system.

b. Subsidiaries as of December 31, 2004:

1. Phonetic Systems Inc. (incorporated on March 24, 1998).

2. Phonetic Systems U.K. Limited (incorporated on January 19, 2001). During 2002 2005, Phonetic Systems U.K. Limited reduced its operation and is in a process of ceasing its operations.

c. On November 15, 2004, ScanSoft Inc., a publicly traded company (Nasdaq: SSFT) (ScanSoft) entered into an agreement and plan of merger with the Company and its shareholders. The Company will survive the merger as a wholly-owned subsidiary of ScanSoft. The aggregate consideration for the shareholders of the Company consists of (i) approximately $35,000 in cash, of which $17,500 will be paid at closing and $17,500 will be paid 24-months after closing, (ii) a contingent payment of up to an additional $35,000 in cash to be paid, if at all, upon the achievement of certain performance targets, and (iii) unvested warrants to purchase 750,000 shares of ScanSoft Common stock (the warrants) that will vest, if at all, upon the achievement of certain performance targets. The transaction has been approved by the boards of directors of both ScanSoft and the Company.

Consummation of the transaction is subject to certain conditions upon closing.

d. The financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has a loss from continuing operations of $9,886 for the year ended December 31, 2004, a working capital deficiency of $3,121 and a net capital deficiency of $1,916 as of December 31, 2004. These conditions raise substantial doubt that the Company will be able to continue as a going concern.

If the merger with ScanSoft, as described in Note 1c, will not be consummated, management plans to start a process of fund raising.

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements are prepared in accordance with United States generally accepted accounting principles (U.S. GAAP).

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

b. Functional currency:

A majority of the revenues of the Company is generated in U.S. dollars (dollars). In addition, part of the costs of the Company is incurred in dollars. The Company s management believes that the dollar is the primary currency of the economic environment in which the Company operates. Thus, the functional currency of the Company is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into dollars in accordance with Statement of Financial Accounting Standards (SFAS) No. 52 of the

PHONETIC SYSTEMS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Financial Accounting Standards Board (FASB). All transaction gains and losses of the remeasurement of monetary balance sheet items are reflected in the statement of operations as financial income or expense, as appropriate.

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany transactions and balances have been eliminated upon consolidation.

d. Cash equivalents:

The Company considers all highly liquid investments originally purchased with maturities of three months or less to be cash equivalents.

e. Inventories:

Inventories are stated at the lower of cost or market value on a specific consumption basis. The inventories represent hardware elements, most of them are considered as finished products which have been installed at the customer s site but for which the Company has not yet recognized the revenue.

f. Long-term lease deposits:

Long-term deposits with maturities of more than one year are included in long-term investments and presented at their cost.

g. Property and equipment:

Property and equipment are stated at cost net of accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets, at the following annual rates:

	%
Computers and peripheral equipment	33 50
Office furniture and equipment	7 33
Motor vehicles	15
Leasehold improvements	Over the term of the lease

The Company s long-lived assets are reviewed for impairment in accordance with SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. In the reported periods, no impairment indicators have been identified.

h. Research and development costs:

Statement of Financial Accounting Standards (SFAS) No. 86 Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed requires capitalization of certain software development costs subsequent to the establishment of technological feasibility.

Based on the Company s product development process, technological feasibility is established upon completion of a working model. Costs incurred by the Company between completion of a working model and the point at which the products are ready for general release have been insignificant. Therefore, all research and development costs have been expensed as incurred.

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PHONETIC SYSTEMS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

i. Severance pay:

Under Israeli law, the Company is required to make severance payments to dismissed employees (including officers) and to employees leaving employment under certain other circumstances.

The Company s liability for severance pay for the Israeli employees is calculated pursuant to Israel s Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment as of the balance sheet date. Employees are entitled to one month salary for each year of employment, or a portion thereof. The Company s liability for all of its employees is fully provided by monthly deposits with insurance policies and by an accrual. The value of these policies is recorded as an asset in the Company s balance sheet.

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israel s Severance Pay Law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies, and includes immaterial profits.

j. Government grants:

Royalty-bearing grants from the Government of Israel, for funding certain approved research and development projects are recognized at the time the Company is entitled to such grants on the basis of the costs incurred, and included as a deduction of research and development costs.

k. Revenue recognition:

The Company generates revenues from software licenses fees, services and post contract support services.

License fees are recognized in accordance with Statement of Position SOP No. 97-2, Software Revenue Recognition , when the software has been delivered and installed, and a persuasive sale agreement exists evidencing a fixed and determinable fee for which collectability is reasonable assured. In most of the Company sales agreements there is an acceptance period. The Company recognizes the revenue after the acceptance period. Fees for post contract support services are deferred and amounts are recognized as earned ratably over the contract period, which generally is one year. Fees for services are recognized as the services are performed. When license, service packet and post contract service fees are combined in multiple element arrangements, the related revenue amounts are recognized based upon vendor-specific objective evidence and, if not available, the deferral of revenue recognition is required until the final element of the arrangement is delivered. In those circumstances in which vendor-specific objective evidence of the undelivered elements exists, revenues from the delivered element is recognizable provided that any discount included in the multiple element arrangement is applied to the delivered element consistent with the residual method, under SOP No. 97-2.

l. Warranty costs:

The Company provides a warranty for up to 90 days at no extra charge. Warranty periods end before the acceptance period is over, therefore no revenue is recognized until warranty period expires. Pursuant to this, the Company did not record a provision for estimated warranty costs. Based on the Company s experience, the amounts are insignificant.

m. Income taxes:

The Company accounts for income taxes in accordance with SFAS 109, Accounting for Income Taxes . This Statement prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets

PHONETIC SYSTEMS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, to reduce deferred tax assets to their estimated realizable value.

n. Concentrations of credit risk:

Financial instruments that potentially subject the Company and its subsidiaries to concentrations of credit risk consist principally of cash and cash equivalents and trade receivables.

Cash and cash equivalents are invested in deposits in major banks in Israel and the United States. Such deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Company s investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

The trade receivables of the Company and its subsidiaries are derived mainly from sales to customers in the United States. The Company performs ongoing credit evaluations of its customers and, to date, has not experienced any material losses. The allowance for doubtful accounts is determined with respect to specific debts that are doubtful of collection.

The Company and its subsidiaries have no off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

o. Accounting for stock-based compensation:

The Company has elected to follow Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation (FIN 44), in accounting for its employee stock option plans. Under APB 25, when the exercise price of the Company s share options is less than the market price of the underlying shares on the measurement date (as defined under APB 25), compensation expense is recognized.

According to the employees option plan, the exercise price shall be paid in full with respect to each share, at the time of exercise, either in cash or in shares issuable upon exercise of the option having a fair market value equal to such exercise price, or in such other manner, as the committee established by the Board of Directors of the Company to administer the restricted stock incentive plan for U.S. employees shall determine, including a cashless exercise procedure through a broker-dealer. Pursuant to the provisions of APB 25, the Company s 1999 stock option plan is decreed a variable plan, since Company s employees can choose to pay the exercise price in shares or cash. Therefore, changes in the intrinsic value of the option, is charged to the statement of operation. In the year 2002 2003, no expenses were charged. In the year 2004, $1,748 was charged to the statements of operations.

The Company adopted the disclosure provisions of SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure , which amended certain provisions of SFAS No. 123, Accounting for Stock-Based Compensation to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. The Company continues to apply the provisions of APB No. 25, in accounting for stock-based compensation.

Pro forma information regarding net loss is required by SFAS No. 123, and has been determined as if the Company had accounted for its employee options under the fair value method prescribed by that statement. The fair value for these options was estimated at the date of grant using the minimum value option valuation model with the following weighted-average assumptions for 2002, 2003 and 2004: risk

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PHONETIC SYSTEMS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

free interest rates 2%, 2% and 1.5% respectively, dividend yields of 0% for each year, and an expected life of the option of four years.

Pro forma information under SFAS No. 123 is as follows:

	Year Ended December 31, 2004	2003	2002
Net loss	$ (9,929)	$ (5,518)	$ (8,822)
Deduct stock-based employee compensation intrinsic value	$ 1,748	$	$
Add stock-based employee compensation fair value	$ (218)	$ (126)	$ (98)
Pro Forma net loss	$ (8,399)	$ (5,644)	$ (8,920)

p. Fair value of financial instruments:

The following methods and assumptions were used by the Company and its subsidiaries in estimating their fair value disclosures for financial instruments:

The carrying amounts of cash and cash equivalents, trade receivables, other accounts receivable, trade payables and other accounts payable approximate their fair value due to the short-term maturity of such instruments.

q. Impact of recently issued accounting standards:

In November 2004, the FASB issued Statement of Financial Accounting Standard No. 151, Inventory Costs, an amendment of ARB No. 43. Chapter 4, (SFAS 151). SFAS 151 amends Accounting Research Bulletin (ARB) No. 43. Chapter 4 to clarify that abnormal amounts of idle facility expense, freight handling costs and wasted materials (spoilage) should be recognized as current-period charges. In addition, SFAS 151 requires that allocation of fixed products overheads to the costs of conversion be based on normal capacity of the production facilities. SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not expect that the adoption of SFAS 151 will have a material effect on its financial position or results of operations.

On December 16, 2004, the FASB issued FASB Statement No. 123 (revised 2004), Share-Based Payment, which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation. Statement 123R supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends FASB Statement No. 95, Statement of Cash Flows. Generally, the approach in Statement 123R is similar to the approach described in Statement 123. However, Statement 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. The Company has not yet determined the impact of applying the various provisions of Statement 123R.

r. Reclassification:

Certain amounts from prior years have been reclassified to conform to current period presentation.

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PHONETIC SYSTEMS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3: OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31,	
	2004	**2003**
Government authorities	$ 273	$ 131
Prepaid expenses	45	55
	$ 318	$ 186

NOTE 4: PROPERTY AND EQUIPMENT

	December 31,	
	2004	**2003**
Cost:		
Computers and peripheral equipment	$ 3,740	$ 2,619
Office furniture and equipment	828	667
Motor vehicles	2	2
Leasehold improvements	3	3
	4,573	3,291
Accumulated depreciation	3,193	2,740
Depreciated cost	$ 1,380	$ 551

As for charges, see Note 7f.

NOTE 5: TRADE PAYABLES

	December 31,	
	2004	**2003**
Suppliers	$ 1,274	$ 364
Related parties (see Note 10)	98	40
	$ 1,372	$ 404

NOTE 6: OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES

	December 31, 2004	December 31, 2003
Employees and payroll accruals	$ 1,279	$ 741
Accrued vacation pay	452	335
Accrued expenses	245	267
	$ 1,976	$ 1,343

NOTE 7: COMMITMENTS AND CONTINGENT LIABILITIES

a. Royalty commitments:

Under the Company s research and development agreements with the Office of the Chief Scientist (OCS) and pursuant to applicable laws, the Company is required to pay royalties at the rate of 3.5% of

PHONETIC SYSTEMS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

sales of products developed with funds provided by OCS, up to an amount equal to 100% of OCS research and development grants, linked to the U.S. dollar.

During 2004 and 2003, the Company paid royalties in the amount of $ 159 and $155, respectively, to the Office of the Chief Scientist. These amounts were charged to cost of revenues for the respective periods.

As of December 31, 2004, the Company has a remaining contingent obligation to pay royalties in the amount of $1,333 (which equals the maximum funds received by the OCS net of royalty paid), including accrued expenses in the amount of $120.

b. Pursuant to a license agreement with Force Computer Inc. (Force), formerly a member company of the Compaq group, Force authorized the use of its technology, and the Company has undertaken to pay Force royalties based on the number of systems sold, as follows:

Number of Sold Systems	**Royalties per System**	
Up to 1,000	$	100
1,001 5,000		75
Over 5,001		50

As of December 31, 2004, the Company has a remaining accrued obligation to pay royalties in the amount of $2.

c. Lease commitments:

In May 2003, a subsidiary signed a sublease agreement beginning in June 2003 for a period of one year and 10 months.

In September 2000, the Company signed a rental agreement beginning in February 2002 for a period of five years plus an option to renew for another five years.

The Group s total rent expenses for the years ended December 31, 2002, 2003 and 2004 were approximately $797, $405 and $337, respectively.

The Company s and subsidiary s future minimum lease commitments under non-cancelable operating leases for the years ended December 31, are as follows:

2005	$ 315
2006	294
2007	40
Total capital lease	$ 649

d. Capital lease:

The Company leases certain equipment under leases classified as capital leases for financial reporting purposes. The following is a schedule of future minimum lease payments under these agreements:

2005	$ 131
2006	79
	$ 210

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PHONETIC SYSTEMS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

e. Contracts with contingent liabilities:

During 2004, the Company was awarded several contracts from various telecommunication service providers to deliver a speech recognition platform for the automation of directory assistance calls. Inherent in the provisioning of such technology platforms in mission critical deployments, certain platform performance criteria are subject to contractual service level milestones. In some of the contracts under the agreement, the Company is subject to penalties if certain performance criteria are not met. These penalties are limited to the total amount that the Company will record from those agreements, and are in the form of credits against future business. The Company has not yet recorded any revenue from those agreements.

The Company has recorded provision of $50 for a penalty payment that is not a contingent payment.

f. Charges:

In order to secure the Company liabilities, the Company issues a limited fixed charge on its property and equipment and cash.

During 2004, the Company recorded a charge in amount of $230 against its property and equipment in favor of lease commitments following a capital lease of computer equipment. In accordance with the lease terms, the Company issued a bank guarantee in an amount of $10 and recorded a limited charge on its bank deposit in favor of the bank, resulting in restricted cash of $10.

In 2004 and 2003, in accordance with rent lease agreement, the Company issued a bank guarantee in favor of the lessor in an amount of $354, as of December 31, 2004 and 2003. During 2004, according to the bank request, the Company recorded a limited charge on its bank deposit in favor of the bank, resulting in restricted cash of $369. No cash was restricted as of December 31, 2003.

Total restricted cash as of December 31, 2004 were $379.

g. Bonuses:

On December 7, 2004, the Board of Directors of the Company (the Board) resolved to provide an additional consideration to employees who are holders of options for the Company s Ordinary shares, which the Board, at its discretion, shall determine, in an amount up to $ 350 (which amount will reduce the first payment to the other shareholders). No amount was accrued as of December 31, 2004. This additional amount is contingent upon plan of merger closing and will be recognized when plan of merger will be consummated.

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PHONETIC SYSTEMS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 8: SHAREHOLDERS EQUITY

a. Composition:

	Authorized December 31,		Issued and Outstanding December 31,	
	2003	2004	2003	2004
	Number of shares			
Shares of NIS 0.01 par value:				
Ordinary shares	7,338,412	7,338,412	478,480	478,480
Preferred A shares	682,000	682,000	679,755	679,755
Preferred B shares	1,117,500	1,117,500	890,781	890,781
Preferred B1 shares	71,104	71,104	15,469	15,469
Preferred BB shares	226,563	226,563		
Preferred BB1 shares	14,221	14,221		
Preferred C shares	650,000	650,000	648,149	648,149
Preferred D shares	500,000	500,000	64,897	64,897
Preferred E shares	1,000,000	1,000,000	113,207	113,207
	11,599,800	11,599,800	2,890,738	2,890,738

Number of options:

	Exercise Price per Option	December 31, 2003	December 31, 2004
		Number of Options	
Options for Ordinary shares	$ 0.8 2.2	119,786	106,683
Series A option exercisable to preferred A shares	$ 0.01	1,700	1,700
Series B option exercisable to preferred B shares	$ 8	226,563	226,563
Series D option exercisable to preferred D shares	$ 2	30,000	30,000
Series D option exercisable to ordinary shares	$ 2	124,675	124,675
		502,724	489,621

*)

The above options were issued in connection with prior financings and do not include options issued to employees (see c. below).

As of December 31, 2004, all options are exercisable.

The holders of Ordinary shares are entitled to rights to vote, to participate in meetings, to receive dividends and to participate in the excess assets upon liquidation of the Company.

The holders of Preferred A shares are entitled to further rights such as to vote in a special or annual meeting of shareholders or any resolution and priority in the event of distribution of assets upon liquidation or a sale transaction of the Company and to acquire shares upon the Company s issuance of shares.

The holders of Preferred B and BB shares shall have the same voting rights as the holders of the Preferred A shares and Ordinary Shares, respectively.

The holders of Preferred B1 and BB1 shares shall have no voting rights except in a merger or consolidation.

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PHONETIC SYSTEMS LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In the event of the distribution of assets upon liquidation of the Company, the holders of BB and BB1 Preferred shares will be conferred the same rights on the assets of the Company as those conferred by Ordinary shares, except for priority payment in the event of liquidation or a sale transaction. See below for further information.

The holders of Preferred C, D and E shares are entitled to the same rights as the holders of the Preferred A shares, except for priority payment in the event of liquidation or a sale transaction. See below for further information.

In the event of liquidation or sale transaction, all the assets of the Company available for distribution among the shareholders shall be distributed as follows: first, to the holders of Preferred E shares pari passu with the holders of Preferred D shares; second, to the holders of Preferred C shares pari passu with the holders of Preferred B and B1 shares; third, to the holders of Preferred A shares, and after which to all the shareholders pari passu on a fully diluted basis.

Notwithstanding the above, with respect to the holders of any series of Preferred shares, if the total amount distributed per share on an as converted basis to each such holder of Preferred shares is greater than twice the liquidation preference of such series of Preferred shares, then the preference for such series of Preferred shares shall not apply.

As of December 31, 2004, the liquidation preferences (assuming exercise of all options) are as follows:

Accumulated Series A	$ 3,651
Accumulated Series B	9,063
Accumulated Series C	10,500
Accumulated Series D	1,318
Accumulated Series E	2,385
	$ 26,917

b. In February 2003, the Company repurchased part of its shares and warrants from certain of its D and E shareholders as follows: 401,246 Series D shares, 789,317 Series E shares and 233,236 warrants exercisable into 336,370 Ordinary shares for a total amount of $ 5,063.

c. Options issued to employees:

Under the Company s 1999 stock option plan and restricted stock incentive plan for U.S. employees, options may be granted to officers, directors, employees and consultants of the Company and its subsidiaries. The options vest primarily over four years. Any options, which are forfeited or not exercised before expiration, become available for future grant.

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PHONETIC SYSTEMS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following is a summary of the Company s stock options granted among the various plans:

	Year Ended December 31, 2002			Year Ended December 31, 2003			Year Ended December 31, 2004		
	Number of Options	Weighted Average Exercise Price		Number of Options	Weighted Average Exercise Price		Number of Options	Weighted Average Exercise Price	
Outstanding at beginning of year	971,437	$	4.285	831,564	$	1.668	714,684	$	1.503
Granted	246,997	$	2.14	129,969	$	1.150	231,125	$	1.95
Exercised	(14,102)	$	0.886	(2,143)	$	1.889			
Forfeited	(372,768)			(244,706)	$	1.925	(20,144)	$	1.02
Outstanding at end of year	831,564	$	1.668	714,684	$	1.503	925,665	$	1.54
Exercisable options	545,117	$	3.7	473,091	$	1.452	626,241	$	1.43

As of December 31, 2004, an aggregate of 338,049 Ordinary shares of the Company are still available for future grant.

In 2002, the Company effected repricing for 127,500 options to purchase ordinary shares. No expenses were charged to the statements of operations on the repricing date.

The options outstanding as of December 31, 2004, have been separated into ranges of exercise price as follows:

Exercise Price	Options Outstanding as of December 31, 2004	Remaining Contractual Life (Years)	Options Exercisable as of December 31, 2004
$0.01	19,600	3 - 4	19,600
$0.8	253,047	4 - 5	253,047
$1.15	408,868	6 - 10	258,714
$1.62	11,450	5 - 7	10,513
$2.20	174,400	9 - 10	31,600
$3.8	10,000	8 - 9	9,375

$4.05	3,500	6	3,500
$4.85	6,400	7	5,761
$6.77	38,400	7	34,131
	925,665		626,241

On December 7, 2004, the Board resolved -

1. To accelerate, prior to the closing, as defined in the merger agreement, all options for the Company s Ordinary shares under the Plans, held by employees who commenced their employment with the Company or a subsidiary on or before January 1, 2004.

2. To take note that under the transactions contemplated by the merger agreement, unvested options for the Company s Ordinary shares issued under the Plans and not accelerated as stated above may be accelerated according to the terms of the Plans or under certain employment contracts.

If the plan of merger is not consummated, the options will not be accelerated.

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PHONETIC SYSTEMS LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of December 31, 2004, notice to employees has not been delivered yet (see Note 13).

d. Warrants issued to consultants:

In April 2002, the Company issued to consultants 68,000 warrants (out of them, 60,000 to a BOD member) for Ordinary shares with an exercised price of $3.8 per share. The warrants have contractual life of 10 years and vest primarily over four years. In 2003, 60,000 of the warrants were forfeited due to the resignation of a BOD member.

During 2004, the Company issued to consultants 41,500 warrants for Ordinary shares with an exercise price of $2.2 per share. 30,000 of these warrants were issued to a related party. The contractual life of 11,500 of the warrants is 10 years and they have a vesting period of four years, and the contractual life of 30,000 of the warrants issued to the related party is 10 years and they vest immediately.

The Company had accounted for its warrants to consultants under the fair value method of SFAS No. 123 and EITF 96-18. The fair value for these warrants was estimated using a Black-Scholes Option-Pricing Model with the following weighted-average assumptions for 2002, 2003 and 2004: risk-free interest rates of 2%, 2% and 1.5%, respectively, dividend yields of 0% for each year, volatility factors of the expected market price of the Company s Ordinary shares of 80% for each year, and an expected life of the warrants of 10 years.

NOTE 9: TAXES ON INCOME

a. Measurement of results for tax purposes under the Income Tax (Inflationary Adjustments) Law, 1985:

Results for tax purposes are measured in terms of earnings in NIS after certain adjustments for increases in Israel s CPI. As explained in Note 2a, the financial statements are measured in U.S. dollars. The difference between the annual change in Israel s CPI and in the NIS/dollar exchange rate causes a further difference between taxable income and the income before taxes shown in the financial statements. In accordance with paragraph 9(f) of SFAS No. 109 the Company has not provided deferred income taxes on the differences between the functional currency and the tax bases of assets and liabilities.

b. Tax benefits under the Law for the Encouragement of Capital Investments, 1959:

The Company s production facilities in Israel have been granted an Approved Enterprise status under the above law. The main benefit arising from such status is the reduction in tax rates on income derived from an Approved Enterprise . Income derived from an Approved Enterprise is tax exempt for a period of the first two years out of the seven year period of benefits. Income derived during the remaining five years of benefits is taxable at the rate of 25%. The period of benefits relating to the Approved Enterprises will take effect in the first year in which the Company will realize taxable income from the Approved Enterprise and will last for seven years but not beyond 2010. The tax-exempt income attributed to the Approved Enterprise can be distributed to shareholders the Company will be liable to corporate tax at the rate of 25%. Under Israeli law, dividends paid out of Approved Enterprise earnings will be subject to a reduced rate of withholding tax of 15%.

As of December 31, 2004, the Company did not benefit from the "Approved Enterprise" status, due to accumulated losses.

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PHONETIC SYSTEMS LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

c. Loss before taxes on income is comprised as follows:

	Year Ended December 31, 2004	2003	2002
Domestic	$ (7,126)	$ (2,767)	$ (4,117)
Foreign	(2,803)	(2,751)	(4,705)
	$ (9,929)	$ (5,518)	$ (8,822)

d. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company s deferred tax assets are as follows:

	December 31, 2004	2003
	Total	Total
Loss carryforward	$ 17,347	$ 12,769
Accrued vacation pay and severance pay	42	(4)
Less valuation allowance	(17,389)	(12,765)
	$	$

The Company and its subsidiaries have provided valuation allowances in respect of deferred tax assets resulting from tax loss carryforward and other temporary differences, since they have a history of losses over the past few years. Management currently believes that it is more likely than not that the deferred tax regarding the loss carryforward and other temporary differences will not be realized.

The Company has an accumulated loss for tax purposes as of December 31, 2004 in the amount of approximately $23,188, which may be carried forward and offset against taxable income in the future for an indefinite period. Through December 31, 2004, the subsidiary had U.S. federal net operating loss carryforward of approximately $23,077 that can be carried forward and offset against taxable income for 20 years and are subject to review and possible adjustment by the Internal Revenue Service. The United States Tax Reform Act of 1986 contains provisions that may limit the net operating loss carryforwards available by the US subsidiary to be used in any given year under certain circumstances, including significant changes in ownership interests.

NOTE 10: RELATED PARTIES TRANSACTIONS

	Year Ended December 31, 2004	2003	2002
Management services	$ 180	$ 218	$
Reimbursement of expenses	39	3	2
	219	221	2
Compensation expenses in respect with warrants granted for management services*)	136	4	
Total	$ 355	$ 225	$ 2

Management fee were paid to one of the shareholders for certain management services in the amount of $15 per month, for the period from October 15, 2002, in accordance with board recommendation to pay such fee. Reimbursements of expenses were paid for two of the shareholders.

*) Includes 30,000 and 46,119 warrants for Ordinary shares for years ended December 31, 2004 and 2003, respectively.

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PHONETIC SYSTEMS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11: SELECTED STATEMENTS OF OPERATIONS DATA

	Year Ended December 31,		
	2004	**2003**	**2002**
Research and development costs, net:			
Research and development costs	$ 4,814	$ 3,071	$ 3,838
Net of grant from the Chief Scientist	665	831	
	$ 4,149	$ 2,240	$ 3,838

NOTE 12: CUSTOMERS AND GEOGRAPHIC INFORMATION

a. Summary information about geographic areas:

The Company operates in one industry segment (see Note 1 for a brief description of the Company s business). The following data is presented in accordance with SFAS No. 131, Disclosure About Segments of an Enterprise and Related Information . Total revenues are attributed to geographic areas based on the location of end customers.

The following presents total revenues and long-lived assets for the year ended December 31, 2004, 2003 and 2002 and as of December 31, 2004, 2003 and 2002, respectively:

	Total Revenues			Long-Lived Assets		
	United States	**Israel**	**Total**	**United States**	**Israel**	**Total**
2004	$ 4,569	$ 395	$ 4,964	$ 716	$ 664	$ 1,380
2003	4,630	86	4,716	91	460	551
2002	4,491	18	4,509	385	864	1,249

b. The Company has no transactions with a single external customer which amounted to 10 percent or more of the Company s revenues.

NOTE 13: SUBSEQUENT EVENTS

On January 21, 2005 and on January 23, 2005, the Company delivered notices to employees regarding the acceleration of all options held by employees. Consequently, the Company is expected to recognize expense in the amount of $ 1,016 in 2005, pursuant to plan of merger consummation. If the plan of merger is not consummated, the options will not be accelerated.

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Nuance Communications, Inc.

Pro Forma Combined Financial Statements

Introduction to Unaudited Pro Forma Combined Financial Statements

On May 14, 2007, Nuance Communications, Inc. (formerly known as ScanSoft, Inc.), (Nuance or the Company), Vicksburg Acquisition Corporation (a wholly owned subsidiary of Nuance Communications, Inc.), and Voice Signal Technologies, Inc. (Voice Signal), signed a definitive Agreement and Plan of Merger. Under the terms of the merger agreement, the Company agreed to acquire VoiceSignal for total purchase consideration of approximately $318.2 million including $210.0 million in cash, estimated transaction costs of $17.3 million and 5.8 million shares of Nuance common stock valued at $15.57 per share. Shares of Nuance common stock issued in the acquisition were valued in accordance with Emerging Issues Task Force (EITF) Issue 99-12; *Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination (EITF 99-12)*. The merger consideration will be paid to VoiceSignal stockholders in accordance with the terms of the merger agreement.

The merger, which is expected to close in August 2007, is subject to customary closing conditions, including regulatory approvals, the adoption of the merger agreement and the approval of the merger by VoiceSignal stockholders.

On March 26, 2007, pursuant to a Share Purchase Agreement dated March 13, 2007, Nuance Communications, Inc. acquired Bluestar Resources Limited (Bluestar), the parent of Focus Enterprises Limited and Focus Infosys Private Limited. Under the purchase agreement the aggregate consideration consists of approximately $54.5 million in cash and the assumption of approximately $2.1 million of debt.

On March 31, 2006, pursuant to the Agreement and Plan of Merger dated as of February 8, 2006, Nuance acquired Dictaphone Corporation in exchange for approximately $359.2 million plus the return of certain cash on Dictaphone s balance sheet, as defined in the merger agreement with Dictaphone. At the effective time of the merger, each share of common stock of Dictaphone converted into the right to receive the per share merger consideration. The merger was accounted for as a purchase of a business.

On June 11, 2007, Nuance received a commitment letter from Citigroup Global Markets Inc., Lehman Brothers Inc. and Goldman Sachs Credit Partners L.P. as arrangers and Bank of America Securities as co-arranger for a syndicate of lenders under our existing credit agreement. The commitment letter, which expires August 30, 2007, relates to an incremental term loan in the amount of $225 million that would be provided under its existing credit agreement. As of June 30, 2007, Nuance had not drawn against the commitment letter. This commitment letter will be drawn only if Nuance closes the VoiceSignal acquisition on or before August 30, 2007, and would be used to fund that acquisition.

On April 5, 2007, Nuance entered into an amended and restated credit facility which consists of a $441.5 million term loan due March 2013 and a $75.0 million revolving credit line due March 2013 (Expanded 2006 Credit Facility). As of June 30, 2007, $440.3 million remained outstanding under the term loan. The available revolving credit line capacity is reduced, as necessary, to account for certain letters of credit outstanding. As of June 30, 2007, there were $17.3 million of letters of credit issued under the revolving credit line and there were no other outstanding borrowings under the revolving credit line. The credit facility was initially entered into in March 2006, at which time the amounts received by Nuance under the original credit facility were used to fund a portion of the acquisition of Dictaphone. A portion of the funds received upon the closing of the Expanded 2006 Credit Facility were used to fund Nuance s acquisition of Bluestar.

The following tables show summary unaudited pro forma combined financial information as if Nuance, Dictaphone, Bluestar and VoiceSignal had been combined as of October 1, 2005 for statement of operations purposes and as if Nuance and VoiceSignal had been combined for balance sheet purposes as of June 30, 2007. Dictaphone and Bluestar are included in Nuance s consolidated balance sheet as of June 30, 2007 and Dictaphone is included in Nuance s consolidated statement of operations for the nine month period ended June 30, 2007, which were included in Nuance s financial statements included herein.

The unaudited pro forma combined financial information of Nuance, Dictaphone, Bluestar and VoiceSignal is based on estimates and assumptions, which have been made solely for purposes of developing such pro forma information. The estimated pro forma adjustments arising from the recently completed

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acquisition of BlueStar and the acquisition of VoiceSignal are derived from the preliminary purchase price allocation.

The historical financial information of Bluestar and VoiceSignal for the year ended December 31, 2006 and the nine months ended June 30, 2007 have been derived from the audited financial statements for December 31, 2006 and the unaudited financial statements for the nine months ended June 30, 2007 of the respective companies. The historical financial information of Dictaphone has been derived from the unaudited financial information for the period from October 1, 2005 through March 31, 2006 (date of acquisition).

The pro forma combined financial statements do not include the historical or pro forma financial information for Mobile Voice Control, Inc. or BeVocal Inc., each of which were acquired by Nuance during Fiscal 2007. The financial statements for these acquired companies and pro forma financial information for the transactions are not included herein as the transactions were determined not to be significant in accordance with the calculations required by Rule 1-02(w) of Regulation S-X of the Securities Exchange Act of 1934, as amended.

The pro forma data are presented for illustrative purposes only and are not necessarily indicative of the operating results or financial position that would have occurred if each transaction had been consummated as of October 1, 2005 for statements of operations purposes, or June 30, 2007, for balance sheet purposes, respectively, nor are the data necessarily indicative of future operating results or financial position. The unaudited pro forma combined financial statements and related notes thereto should be read in conjunction with the historical consolidated financial statements of Nuance, Dictaphone, Bluestar and VoiceSignal, and related notes thereto beginning on page F-3, and Management s Discussion and Analysis of Nuance s Financial Condition and Results of Operations beginning on page 76, and the historical consolidated financial statements of VoiceSignal beginning on F-97. See the section entitled Where You Can Find More Information on page 143.

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NUANCE COMMUNICATIONS, INC.

UNAUDITED PRO FORMA COMBINED BALANCE SHEET
As of June 30, 2007

	Historical Nuance (A)	Historical VoiceSignal (B)	Pro Forma Adjustments	Pro Forma Combined
	(In thousands)			
ASSETS				
Current assets:				
Cash and cash equivalents	$ 168,031	$ 9,316	$ 1,643 (3A)	$ 178,990
Short term investments	7,846			7,846
Accounts receivable, net	131,741	5,338		137,079
Acquired unbilled accounts receivable	8,213		16,500(3B)	24,713
Inventories, net	8,391			8,391
Prepaid expenses and other current assets	15,233	1,098	(174)(3D)	16,157
Deferred tax assets	420	4,027	(4,027)(3H)	420
Total current assets	339,875	19,779	13,942	373,596
Land, building and equipment, net	37,018	733		37,751
Goodwill	882,987		228,289 (3I)	1,111,276
Other intangible assets, net	259,826	1,789	59,711 (3G)	321,326
Other long-term assets	36,650	181	(4,033)(3D)	32,798
Total assets	$ 1,556,356	$ 22,482	$ 297,909	$ 1,876,747
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Current portion of long-term debt and obligations under capital leases	$ 5,062	$ 27	$ 2,250 (3J)	7,339
Accounts payable	42,490	1,272		43,762
Accrued expenses	66,757	1,022	400 (3F)	68,179
Current portion of accrued business combination costs	13,402			13,402
Current portion of license obligation		1,032		1,032
Deferred maintenance revenue	67,301			67,301
Unearned revenue and customer deposits	31,563	3,850	(3,850)(3E)	31,563
Total current liabilities	226,575	7,203	(1,200)	232,578
Long-term debt and obligations under capital leases, net of current portion	436,461		222,750 (3J)	659,211
Accrued business combination costs, net of current portion	37,991			37,991
License obligation, net of current portion		786		786

Deferred revenue, net of current portion	11,286	804	(804)(3E)	11,286
Deferred tax liability	32,161			32,161
Other liabilities	62,267			62,267
Total liabilities	806,741	8,793	220,746	1,036,280
Redeemable convertible preferred stock Series C and Series D		33,184	(33,184)(3C)	
Commitments and contingencies Stockholders equity:				
Preferred stock	4,631	7	(7)(3C)	4,631
Common stock	188	17	(11)(3C)	194
Additional paid-in capital	954,265	2,035	88,811 (3C)	1,045,111
Treasury stock, at cost	(14,694)			(14,694)
Accumulated other comprehensive income	5,950	(19)	19 (3C)	5,950
Accumulated deficit	(200,725)	(21,535)	21,535 (3C)	(200,725)
Total stockholders equity (deficit)	749,615	(19,495)	110,347	840,467
Total liabilities and stockholders equity	$ 1,556,356	$ 22,482	$ 297,909	$ 1,876,747

(A) As reported in Nuance s unaudited balance sheet included in its Quarterly Report on Form 10-Q as of June 30, 2007, as filed with the SEC.
(B) As derived from VoiceSignal s unaudited financial information as of June 30, 2007.

See accompanying Notes to Unaudited Pro Forma Combined Financial Statements.

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NUANCE COMMUNICATIONS INC.

UNAUDITED PRO FORMA COMBINED STATEMENT OF OPERATIONS
For the Twelve Months Ended September 30, 2006

	Historical Nuance for the Twelve Months Ended September 30, 2006 (A)	Historical Dictaphone for the Six Months Ended March 31, 2006 (B)	Pro Forma Adjustments	Historical Bluestar for the Twelve Months Ended December 31, 2006 (C)	Pro Forma Adjustments	Historical VoiceSignal for the Twelve Months Ended December 31, 2006 (D)	Pro Forma Adjustments	Pro Forma Combined
	(In thousands, except per share amounts)							
oduct and censing	$ 235,825	$ 35,479	$ (175)(7)	$	$	$ 21,519	$	$ 292,648
ofessional rvices, subscription d hosting	81,320	8,013		18,818	(2,535)(4)	3,082		108,698
aintenance and pport	71,365	38,513						109,878
otal revenue	388,510	82,005	(175)	18,818	(2,535)	24,601		511,224
osts and expenses:								
ost of product and censing	31,394	22,187	(175)(7)					53,406
ost of professional rvices, subscription d hosting	59,015	8,480		9,947	(2,535)(4)	1,351		76,258
ost of maintenance d support	17,723	8,490						26,213
ost of revenue from nortization of tangible assets	12,911	1,570	83(8)		379(5)	474	1,386(1)	16,803
otal cost of revenue	121,043	40,727	(92)	9,947	(2,156)	1,825	1,386	172,680
ross Margin	267,467	41,278	(83)	8,871	(379)	22,776	(1,386)	338,544
perating expenses:								
esearch and velopment	59,403	4,056				6,001		69,460

ales and marketing	128,412	17,700		577		4,214		150,903
eneral and ministrative	55,343	16,371		3,127		5,356		80,197
mortization of her intangible sets	17,172	2,029	3,610(8)		2,098(5)		6,457(1)	31,366
erger expense		22,379						22,379
ost of and loss lated to sale of visions		2,367						2,367
estructuring and her charges redits), net	(1,233)							(1,233
otal operating penses	259,097	64,902	3,610	3,704	2,098	15,571	6,457	355,439
come (loss) from erations	8,370	(23,624)	(3,693)	5,167	(2,477)	7,205	(7,843)	(16,895
her income xpense):								
terest income	3,305	447				144		3,896
terest expense	(17,614)	(180)	(13,768)(9)	(171)	(5,241)(6)	(154)	(19,251)(2)	(56,379
her (expense) come, net	(1,132)	171		(586)				(1,547
come (loss) before come taxes	(7,071)	(23,186)	(17,461)	4,410	(7,718)	7,195	(27,094)	(70,925
ovision for (benefit om) income taxes	15,144	453		726		(187)		16,136
come (loss) before mulative effect of counting change	(22,215)	(23,639)	(17,461)	3,684	(7,718)	7,382	(27,094)	(87,061
umulative effect of counting change	(672)							(672
et income (loss)	$ (22,887)	$ (23,639)	$ (17,461)	$ 3,684	$ (7,718)	$ 7,382	$ (27,094)	$ (87,733
asic and diluted rnings per share								
oss before mulative effect of counting change	$ (0.13)							$ (0.51
umulative effect of counting change	$ (0.01)							$ (0.01
et loss per share	$ (0.14)							$ (0.52
eighted average mmon shares								

tstanding:			
asic and diluted	163,873	5,837(3C)	169,71(

See accompanying Notes to Unaudited Pro Forma Combined Financial Statements.

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NUANCE COMMUNICATIONS INC.

UNAUDITED PRO FORMA COMBINED STATEMENT OF OPERATIONS (Continued)

(A) As reported in Nuance s annual report on Form 10-K, as filed with the SEC.

(B) Derived from Dictaphone s unaudited financial information for the period from October 1, 2005 through March 31, 2006 (date of acquisition).

(C) As reported in Bluestar s audited financial statements for the twelve months ended December 31, 2006.

(D) As reported in VoiceSignal s audited financial statements for the twelve months ended December 31, 2006.

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NUANCE COMMUNICATIONS, INC.

UNAUDITED PRO FORMA COMBINED STATEMENT OF OPERATIONS
For the Nine Months Ended June 30, 2007

	Historical Nuance for the Nine Months Ended June 30, 2007(A)	Historical Bluestar for the Period from October 1, 2006 to March 26, 2007(B)	Pro Forma Adjustments	Historical VoiceSignal for the Nine Months Ended June 30, 2007(C)	Pro Forma Adjustments	Pro Forma Combined
	(In thousands, except per share amounts)					
Product and licensing	$ 220,931	$	$	$ 18,183	$	$ 239,114
Professional services, subscription and hosting	110,078	10,563	(1,161)(4)	2,006		121,486
Maintenance and support	91,113					91,113
Total revenue	422,122	10,563	(1,161)	20,189		451,713
Costs and expenses:						
Cost of product and licensing	31,734					31,734
Cost of professional services, subscription and hosting	75,458	6,611	(1,161)(4)	935		81,843
Cost of maintenance and support	20,512					20,512
Cost of revenue from amortization of intangible assets	9,209		184(5)	376	1,019(1)	10,788
Total cost of revenue	136,913	6,611	(977)	1,311	1,019	144,877
Gross Margin	285,209	3,952	(184)	18,878	(1,019)	306,836
Operating expenses:						

Research and development	53,748			4,888		58,636
Sales and marketing	132,454	381		3,594		136,429
General and administrative	52,630	2,037		3,714		58,381
Amortization of other intangible assets	16,613		1,468(5)		13,619(1)	31,700
Merger expense						
Cost of and loss related to sale of divisions						
Restructuring and other charges (credits), net	(54)					(54)
Total operating expenses	255,391	2,418	1,468	12,196	13,619	285,092
Income (loss) from operations	29,818	1,534	(1,652)	6,682	(14,638)	21,744
Other income (expense):						
Interest income	4,100			46		4,146
Interest expense	(24,301)	(90)	(2,621)(6)		(14,438)(2)	(41,450)
Other (expense) income, net	(476)	74				(402)
Income (loss) before income taxes	9,141	1,518	(4,273)	6,728	(29,076)	(15,962)
Provision for (benefit from) income taxes	19,740	278		(366)		19,652
Net income (loss)	$ (10,599)	$ 1,240	$ (4,273)	$ 7,094	$ (29,076)	$ (35,614)
Basic and diluted earnings per share						
Net loss per share	$ (0.06)					$ (0.20)
Weighted average common shares outstanding:						
Basic and diluted	173,786				5,837(3C)	179,623

(A) As reported in Nuance s Quarterly Report on Form 10-Q, as filed with the SEC.

(B) As derived from Bluestar s unaudited financial information for the period from October 1, 2006 to March 26, 2007.

(C) As derived from VoiceSignal s unaudited financial information for the nine months ended June 30, 2007.

See accompanying Notes to Unaudited Pro Forma Combined Financial Statements.

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS

A summary of the estimated consideration and preliminary purchase price allocation as of June 30, 2007 for the VoiceSignal acquisition is as follows (in thousands):

Estimated Purchase Consideration	
Cash	$ 210,000
Common Stock	90,852
Transaction Costs	17,345
Total Estimated Purchase Consideration	$ 318,197
Preliminary Allocation of Purchase Consideration	
Current Assets	$ 32,078
Property & Equipment	733
Other Assets	136
Identifiable Intangible Assets	61,500
Goodwill	228,289
Total Assets Acquired	322,736
Current Liabilities	(3,753)
Long-Term Liabilities	(786)
Total Liabilities Assumed	(4,539)
	$ 318,197

Current assets acquired primarily relate to cash, accounts receivable and acquired unbilled accounts receivable. Current liabilities assumed primarily relate to payables to employees and accounts payable, as well as current obligations under license arrangements. Long term liabilities assumed consist primarily of non-current obligations under license arrangements.

The acquisition of VoiceSignal by Nuance is expected to give rise to the consolidation and elimination of certain VoiceSignal and Nuance personnel. The pro forma adjustments do not include any amounts which may be recorded in accordance with Emerging Issues Task Force 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination* as Nuance does not expect that a final integration plan will be established until just prior to or immediately after the closing of the transaction. However, Nuance along with its financial advisors Lehman Brothers, has prepared a preliminary analysis of restructuring activities. Nuance expects full year operating synergies of approximately $8 million to $10 million resulting from these activities, which have not been reflected in the pro forma adjustments.

Nuance believes that certain restructuring actions are an integral component of the acquisition plan to enable the benefits of the combined companies to be optimized and the benefits of the acquisition to be realized. Nuance expects to complete these restructuring efforts within one year of the closing.

Nuance believes the $61.5 million of value ascribed to identifiable intangible assets will be allocated to completed and core technology, and customer relationships.

The amount assigned to identifiable intangible assets acquired was based on their respective fair values determined as of the acquisition date. The excess of the purchase price over the tangible and identifiable assets was recorded as goodwill and amounted to approximately $228.3 million. In accordance with current accounting standards, the goodwill is not being amortized and will be tested for impairment as required by SFAS No. 142.

The pro forma data are presented for illustrative purposes only and are not necessarily indicative of the operating results or financial position that would have occurred if each transaction had been consummated as

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS (Continued)

of October 1, 2005 for the income statement or as of June 30, 2007 for the balance sheet, nor are the data necessarily indicative of future operating results or financial position.

Pro forma adjustments reflect only those adjustments which are factually determinable and do not include the impact of contingencies which will not be known until the resolution of the contingency. The allocation of the purchase price relating to these acquisitions is preliminary, pending the finalization of Nuance s review of certain of the accounts and the finalization of the appraisal of identifiable intangible assets.

VoiceSignal

(1) Adjustment to record amortization expense of $8,317,000 and $15,014,000 for the identifiable intangible assets, partially offset by an adjustment to eliminate amortization expense of $474,000 and $376,000 related to historical intangible assets of VoiceSignal for the twelve months ended September 30, 2006 and the nine months ended June 30, 2007, respectively, as if the acquisition had occurred on October 1, 2005. The allocation of the purchase price to tangible and identifiable intangible assets acquired and liabilities assumed is preliminary pending collection of data to evaluate estimates of future revenues and earnings to determine a discounted cash flow valuation of certain intangibles that meet the separate recognition criteria of SFAS No. 141. Nuance s preliminary assessment is that the weighted average useful life of the acquired identifiable intangible assets will be approximately 5.4 years. The acquired identifiable intangible assets will be amortized over a term consistent with their economic life. Core and completed technologies will be amortized to cost of revenue using the straight line method. Customer relationships will be amortized to operating expense over a term consistent with the related revenue streams.

An increase in the amount of identifiable intangible assets or a change in the allocation between the acquired identifiable intangible assets and goodwill for the VoiceSignal acquisition of $1,000,000 would result in a change in pro forma amortization expense of approximately $135,000 and $244,000 for the twelve months ended September 30, 2006 and the nine months ended June 30, 2007, respectively. An increase in the weighted average useful life of the acquired identifiable intangible assets of one year would result in a decrease in pro forma amortization expense of approximately $1,785,000 and $1,339,000 for the twelve months ended September 30, 2006 and the nine months ended June 30, 2007, respectively. A decrease in the weighted average useful life of the acquired identifiable intangible assets of one year would result in an increase in pro forma amortization expense of approximately $2,599,000 and $1,949,000 for the twelve months ended September 30, 2006 and the nine months ended June 30, 2007, respectively.

(2) Adjustment to record interest expense of $19,251,000 and $14,438,000 for the year ended September 30, 2006 and the nine months ended June 30, 2007, respectively, associated with the $225 million term loan issued in connection with the VoiceSignal acquisition based on an interest rate of 7.84%, including amortization of debt issuance costs and an associated increase of 0.25% on Nuance s pre-existing loan balance. A change of 0.25% in the interest rate would result in an annualized change of $563,000 in interest expense.

(3) Adjustments to record the fair value of the assets acquired and the liabilities assumed of VoiceSignal, subject to adjustment pending the completion of a post-closing review of the purchased assets. Adjustments assume the acquisition was consummated June 30, 2007 and include the following:

(A) Adjustment to record $225,000,000 of cash received from issuance of Term Loan net of $210,000,000 of cash paid to acquire VoiceSignal, $2,812,000 of debt issuance costs paid, and $10,545,000 for transaction fees paid, which include legal, accounting and tax fees, investment bankers   fees, intellectual property filing fees and due diligence fees incurred by Nuance. These transaction fees are included in the total estimated purchase consideration.

NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS (Continued)

(B) Adjustment to record acquired unbilled accounts receivables totaling $16,500,000. The adjustment represents guaranteed contractual payments on technology previously delivered by VoiceSignal that are not yet billable per the contracts.

(C) Adjustment to VoiceSignal historical data made to eliminate $19,495,000 of stockholders deficit and $33,184,000 of redeemable convertible preferred stock.

Adjustment to record common stock of $6,000 and Additional Paid in Capital of $90,846,000 related to the estimated issuance of 5,836,576 shares of Nuance common stock at a value of $15.57. Shares of Nuance common stock issued in the acquisition were valued in accordance with Emerging Issues Task Force (EITF) Issue 99-12; *Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination.* Accordingly, the share price was based upon the five day average of the adjusted closing price of Nuance stock, two days prior to the announcement and the three days subsequent (including the day of announcement).

(D) Adjustment to eliminate $174,000 and $45,000 of prepaid and other long term assets, respectively that existed as of June 30, 2007. Adjustment to reflect $2,812,000 of debt issuance costs related to the Term Loan issued in connection with the VoiceSignal acquisition.

Adjustment to reclassify approximately $6,800,000 of previously capitalized legal fees by Nuance to an intangible asset in connection with the settlement of a preexisting relationship; in accordance with Emerging Issues Task Force (EITF) 04-01, Accounting for Preexisting Relationships between Parties to a Business Combination. The Company reviewed its previously capitalized legal fees and determined that there was no gain or loss on the settlement of the preexisting relationship and that the fees were incremental consideration and are reflected as part of the transaction costs. The Company has preliminarily determined that this intangible asset has an indefinite life and has been included in goodwill. If upon final determination we conclude that a portion of this asset has a finite life the asset would need to be amortized over the remaining economic life of the intangible asset, approximately six years. Assuming the entire amount is recorded as an intangible asset with a weighted average useful life of six years, the pro forma amortization expense would increase by $1,133,000 and $850,000 for the twelve months ended September 30, 2006 and the nine months ended June 30, 2007, respectively.

(E) Adjustment to eliminate $3,850,000 and $804,000 of current and long term deferred revenues, respectively that existed as of June 30, 2007. The adjustment is preliminary and is subject to a detailed review of VoiceSignal s deferred revenues. The final adjustments will be based on the guidance provided in EITF No. 01-03, *Accounting in a Purchase Business Combination for Deferred Revenue of an Acquiree*.

(F) Adjustment to record $400,000 of payments due related to employee benefit programs.

(G) Adjustment to record the fair value of intangible assets acquired totaling $61,500,000, partially offset by an adjustment to eliminate $1,789,000 of historical intangible assets that existed as of June 30, 2007.

(H) Adjustment to record valuation allowance of $4,027,000 related to deferred tax assets of VoiceSignal.

(I) Adjustment to record goodwill of $228,289,000 (assuming for the purpose of these pro forma financial statements that the acquisition has been consummated on June 30, 2007) as a result of the purchase consideration in excess of the fair value of assets acquired and liabilities assumed.

(J) Adjustment to record the $225,000,000 Term Loan issued in connection with the VoiceSignal acquisition including $2,812,000 of debt issuance costs and an annual interest rate of 7.84%.

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NUANCE COMMUNICATIONS, INC.

NOTES TO UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS (Continued)

Bluestar

(4) Adjustment to eliminate intercompany professional services, subscription and hosting revenue and cost of professional services, subscription and hosting revenue totaling $2,535,000 and $1,161,000 for the year ended September 30, 2006 and the nine months ended June 30, 2007, respectively.

(5) Adjustment to record amortization expense of $2,477,000 and $1,652,000 for the identifiable intangible assets acquisition for the twelve months ended September 30, 2006 and the nine months ended June 30, 2007, respectively, as if the acquisition had occurred on October 1, 2005. Core and completed technology are amortized to cost of revenue on a straight-line basis while customer relationships and non-compete agreements are amortized to operating expenses over a term consistent with the related cash flow streams.

(6) Adjustment to record interest expense of $5,241,000 and $2,621,000 for the twelve months ended September 30, 2006 and the nine months ended June 30, 2007, respectively, associated with the debt assumed in connection with the Bluestar acquisition based on an interest rate of 7.3%. Interest expense for the period subsequent to the Bluestar acquisition, March 26, 2007 through June 30, 2007, is included in Nuance s historical financial statements for the nine months ended June 30, 2007. A change of 0.25% in the interest rate would result in an annualized change of $140,000 in interest expense.

Dictaphone and the Credit Facility

(7) Adjustment to eliminate intercompany product license revenue and cost of product license revenue totaling $175,000 for the six months ended March 31, 2006.

(8) Adjustment to record amortization expense of $7,292,000 for the identifiable intangible assets, partially offset by an adjustment to eliminate amortization expense of $3,599,000 related to intangible assets of Dictaphone which existed prior to the acquisition for the year ended September 30, 2006 as if the acquisition had occurred on October 1, 2005.

(9) Adjustment to record interest expense of $13,768,000 for the year ended September 30, 2006 and related to funds borrowed under the 2006 Credit Facility entered into in March 2006. This expense assumes an interest rate of 7.0% and also includes the amortization of the $9.0 million of debt issuance costs. The rate as of March 31, 2006 was 6.83%, a change of 0.25% in the interest rate would result in an annualized change of $888,000 in interest expense.

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ANNEX A
EXECUTION COPY

AGREEMENT AND PLAN OF MERGER

BY AND AMONG

NUANCE COMMUNICATIONS, INC.

VICKSBURG ACQUISITION CORPORATION

VOICE SIGNAL TECHNOLOGIES, INC.

U.S. BANK NATIONAL ASSOCIATION, AS ESCROW AGENT

AND

STATA VENTURE PARTNERS, LLC, AS STOCKHOLDER REPRESENTATIVE

DATED AS OF MAY 14, 2007

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INDEX OF EXHIBITS

Exhibit	Description
Exhibit A	Form of Voting Agreement
Exhibit B	Form of Certificate of Merger
Exhibit C	Form of Proprietary Information Agreement
Exhibit D	List of Persons whose knowledge constitutes Knowledge
Exhibit E	Merger Consideration Distribution
Exhibit F	Form of Release Agreement

SCHEDULES

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THIS AGREEMENT AND PLAN OF MERGER (the AGREEMENT) is made and entered into as of May 14, 2007 by and among Nuance Communications, Inc., a Delaware corporation (PARENT), Vicksburg Acquisition Corporation, a Delaware corporation and a wholly owned subsidiary of Parent (SUB), Voice Signal Technologies, Inc., a Delaware corporation (the COMPANY), U.S. Bank National Association, to act as escrow agent hereunder, and as a party to this Agreement solely with respect to ARTICLE VII herein (the ESCROW AGENT) and Stata Venture Partners, LLC, who will serve as the representative of the Company s stockholders, and is referred to herein from time to time as the STOCKHOLDER REPRESENTATIVE.

RECITALS

A. The Boards of Directors of each of Parent, Sub and the Company believe it is in the best interests of each company and its respective stockholders that Parent acquire the Company through the statutory merger of Sub with and into the Company (the MERGER) and, in furtherance thereof, have approved the Merger.

B. Pursuant to the Merger, among other things, and subject to the terms and conditions of this Agreement, all of the issued and outstanding capital stock of the Company shall be converted into the right to receive the consideration set forth herein.

C. A portion of the consideration payable in connection with the Merger shall be placed in escrow as security for the indemnification obligations set forth in this Agreement.

D. The Company, on the one hand, and Parent and Sub, on the other hand, desire to make certain representations, warranties, covenants and other agreements in connection with the Merger.

E. Concurrent with the execution and delivery of this Agreement, as a material inducement to Parent and Sub to enter into this Agreement, all officers and directors of the Company, and certain other affiliated stockholders of the Company are entering into Voting Agreements, in substantially the form attached hereto as EXHIBIT A (the VOTING AGREEMENTS), with Parent, pursuant to which such stockholders have irrevocably agreed to vote in favor of the Merger and the transactions contemplated thereby and to other matters set forth therein.

F. Concurrent with the execution and delivery of this Agreement, as a material inducement to the Company and the Stockholders to enter into this Agreement, Parent and certain individuals are entering into Release Agreements substantially in the form attached hereto as EXHIBIT F (the RELEASE AGREEMENTS), pursuant to which Parent and such individuals are releasing each other from claims related to the Parent/Company Litigation (as defined below).

NOW, THEREFORE, in consideration of the mutual agreements, covenants and other promises set forth herein, the mutual benefits to be gained by the performance thereof, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged and accepted, the parties hereby agree as follows:

ARTICLE I

THE MERGER

1.1 *The Merger.* At the Effective Time (as defined in SECTION 1.2 hereof) and subject to and upon the terms and conditions of this Agreement and the applicable provisions of the General Corporation Law of the State of Delaware (DELAWARE LAW), Sub shall be merged with and into the Company, the separate corporate existence of Sub shall cease, and the Company shall continue as the surviving corporation and as a wholly owned subsidiary of Parent. The surviving corporation after the Merger is hereinafter referred to as the SURVIVING CORPORATION.

1.2 *Effective Time.* Unless this Agreement is earlier terminated pursuant to Section 8.1 hereof, the closing of the Merger (the CLOSING) will take place as promptly as practicable after the execution and delivery hereof by the parties hereto, and following satisfaction or waiver of the conditions set forth in Article VI hereof, at the offices of Wilson Sonsini Goodrich & Rosati, Professional Corporation, 1700 K

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Street NW, Fifth Floor, Washington, D.C., unless another time or place is mutually agreed upon in writing by Parent and the Company. The date upon which the Closing actually occurs shall be referred to herein as the CLOSING DATE. On the Closing Date, the parties hereto shall cause the Merger to be consummated by filing a Certificate of Merger in substantially the form attached hereto as EXHIBIT B, with the Secretary of State of the State of Delaware (the CERTIFICATE OF MERGER), in accordance with the applicable provisions of Delaware Law (the time of the acceptance of such filing by the Secretary of State of the State of Delaware such filing shall be referred to herein as the EFFECTIVE TIME).

1.3 *Effects of the Merger.* At the Effective Time, the effect of the Merger shall be as provided in the applicable provisions of Delaware Law. Without limiting the generality of the foregoing, and subject thereto, at the Effective Time, except as otherwise agreed to pursuant to the terms of this Agreement, all of the property, rights, privileges, powers and franchises of the Company shall vest in the Surviving Corporation, and all debts, liabilities and duties of the Company shall become the debts, liabilities and duties of the Surviving Corporation.

1.4 *Organizational Documents.* Unless otherwise determined by Parent prior to the Effective Time, the certificate of incorporation of the Surviving Corporation shall be amended and restated as of the Effective Time to be identical to the certificate of incorporation of Sub as in effect immediately prior to the Effective Time, until thereafter amended in accordance with Delaware Law; provided, however, that at the Effective Time, Article I of the certificate of incorporation of the Surviving Corporation shall be amended and restated in its entirety to read as follows: The name of the corporation is Voice Signal Technologies, Inc.

(a) Unless otherwise determined by Parent prior to the Effective Time, the bylaws of Sub, as in effect immediately prior to the Effective Time, shall be the bylaws of the Surviving Corporation at the Effective Time until thereafter amended in accordance with Delaware Law.

1.5 *Directors/officers.*

(a) *Directors of the Company.* Unless otherwise determined by Parent prior to the Effective Time, the directors of Sub immediately prior to the Effective Time shall be the directors of the Surviving Corporation immediately after the Effective Time, each to hold office until their successors are duly elected and qualified.

(b) *Officers of the Company.* Unless otherwise determined by Parent prior to the Effective Time, the officers of Sub immediately prior to the Effective Time shall be the officers of the Surviving Corporation immediately after the Effective Time, each to hold office in accordance with the provisions of the bylaws of the Surviving Corporation.

1.6 *Definitions.* For all purposes of this Agreement, the following terms shall have the following respective meanings:

(a) *Business Day(s)* shall mean each day that is not a Saturday, Sunday or holiday on which banking institutions located in New York, New York are authorized or obligated by Law or executive order to close.

(b) *Cash Consideration* shall mean $210,000,000, plus the aggregate amount of cash proceeds received by the Company at any time after the date of this Agreement in connection with the exercise of any Company Option, and less the amount of Third Party Expenses set forth on the Statement of Expenses.

(c) *Company Capital Stock* shall mean the Company Common Stock, the Company Preferred Stock and any other shares of capital stock, if any, of the Company, taken together.

(d) *Company Common Stock* shall mean shares of common stock, $0.001 par value per share, of the Company.

(e) *Company Material Adverse Effect* shall mean any change, event or effect that is materially adverse to the business, assets (whether tangible or intangible), financial condition, operations or capitalization of the Company and any subsidiaries, taken as a whole; provided, however, that, in no event shall any of the following be taken into account in determining whether there has been or will be a

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Company Material Adverse Effect: (A) any effect resulting from changes or effects in general worldwide or United States economic, capital market or political conditions (which changes or effects do not disproportionately affect the Company), (B) any effect resulting from changes or effects generally affecting the industries or markets in which the Company operates (which changes or effects do not disproportionately affect the Company), (C) any effect resulting from any act of war or terrorism (or, in each case, any escalation thereof) (which changes or effects do not disproportionately affect the Company), (D) any changes in applicable Laws or GAAP, (E) any effect resulting directly from the announcement or pendency of the Merger, or (F) any change, event or effect resulting from or arising out of any action on the part of Parent or any of its affiliates, including, without limitation, actions taken in the ordinary course of business.

(f) *Company Options* Shall mean all issued and outstanding options (including commitments to grant options to purchase or otherwise acquire Company Common Stock (whether or not vested) held by any person, each of whom are listed on SECTION 2.2(B) of the Disclosure Schedule.

(g) *Company Preferred Stock* shall mean shares of Company Series A Convertible Preferred Stock, Company Series B Convertible Preferred Stock, Company Series C Convertible Preferred Stock and Company Series D Convertible Preferred Stock, taken together.

(h) *Company Series a Convertible Preferred Stock* shall mean shares of Series A Preferred Stock, par value $0.001 per share, of the Company.

(i) *Company Series b Convertible Preferred Stock* shall mean shares of Series B Preferred Stock, par value $0.001 per share, of the Company.

(j) *Company Series c Convertible Preferred Stock* shall mean shares of Series C Preferred Stock, par value $0.001 per share, of the Company.

(k) *Company Series d Convertible Preferred Stock* shall mean shares of Series D Preferred Stock, par value $0.001 per share, of the Company.

(l) *Contract* shall mean any written or oral agreement, contract, subcontract, lease, binding understanding, instrument, note, bond, mortgage, indenture, option, warranty, purchase order, license, sublicense, benefit plan, obligation, commitment or undertaking of any nature.

(m) *Escrow Amount* shall mean $30,000,000 of the Cash Consideration.

(n) *Exchange Act* shall mean the Securities Exchange Act of 1934, as amended.

(o) *Gaap* shall mean United States generally accepted accounting principles consistently applied.

(p) *Knowledge* *or* *Known* shall mean, with respect to the Company, the knowledge of the persons set forth on EXHIBIT D after reasonable inquiry of those employees of the Company whom such persons reasonably believe would have actual knowledge of the matters represented.

(q) *Laws* shall mean any national, federal, state, local or foreign law, rule, regulation, statute, ordinance, order, judgment, decree, permit, franchise, license or other governmental restriction or requirement of any kind.

(r) *Lien* shall mean any lien, pledge, charge, claim, mortgage, security interest or other encumbrance of any sort.

(s) *Merger Consideration* shall mean the Cash Consideration and the Stock Consideration.

(t) *New Nda* shall mean the Non-Disclosure and F.R.E. 408 Agreement between Parent and the Company, entered into April 30, 2007.

(u) *Parent Common Stock* shall mean the common stock, par value $0.001 per share, of Parent.

(v) *Parent/company Litigation* shall mean any current or future litigation between Parent or any of its affiliates, on the one hand, and the Company or any of its affiliates on the other hand (other than to the extent that such litigation arises out of or relates to this Agreement and the transactions contemplated hereby).

(w) *Parent Material Adverse Effect* shall mean any change, event or effect that (i) is materially adverse to the business, assets (whether tangible or intangible), financial condition, or results of operations of Parent and its subsidiaries, taken as a whole or (ii) will or is reasonably likely to materially impede the ability of Parent to timely consummate the transactions contemplated by this Agreement in accordance with the terms hereof; provided, however, that, for purposes of clause (i) above, in no event shall any of the following be taken into account in determining whether there has been or will be a Parent Material Adverse Effect: (A) any effect resulting from changes or effects in general worldwide or United States economic, capital market or political conditions (which changes or effects do not disproportionately affect Parent), (B) any effect resulting from changes or effects generally affecting the industries or markets in which Parent operates (which changes or effects do not disproportionately affect Parent), (C) any effect resulting from any act of war or terrorism (or, in each case, any escalation thereof) (which changes or effects do not disproportionately affect Parent), (D) any changes in applicable Laws or GAAP (E) any effect resulting directly from the announcement or pendency of the Merger, (F) any change in and of itself in Parent s Stock price or trading volume, or (G) any change, event or effect resulting from or arising out of any action on the part of the Company or any of its affiliates, including, without limitation, actions taken in the ordinary course of business.

(x) *Plans* shall mean the Company s Amended and Restated 1998 Stock Option Plan.

(y) *Pro Rata Portion* shall mean, with respect to each Stockholder entitled to receive a portion of the Cash Consideration, the quotient obtained by dividing (A) the portion of the Cash Consideration that such Stockholder is entitled to receive at the Effective Time pursuant to SECTION Y1.7(A) (including the portion thereof to be contributed to the Escrow Fund pursuant to Section 1.7(b)) by (B) the Cash Consideration.

(z) *Related Agreements* shall mean the Certificate of Merger, the Voting Agreements, the Release Agreements, the Mutual Non-Disclosure and F.R.E. Agreement executed by the Company on October 30, 2006 and executed by Parent on November 2, 2006, as amended and in effect from time to time (the CONFIDENTIAL DISCLOSURE AGREEMENT and the New NDA.

(aa) *Sas-100* shall mean Statement of Auditing Standards No. 100.

(bb) *Sec* shall mean the United States Securities and Exchange Commission.

(cc) *Securities Act* shall mean the Securities Act of 1933, as amended.

(dd) *Signing Price* Shall mean $15.42 (reflecting the average of the reported closing price of the Parent Common Stock for the ten (10) trading days immediately preceding the date of this Agreement), proportionally adjusted for any stock split, stock dividend, reverse stock split, or similar subdivision or combination of the outstanding shares of Parent Common Stock occurring after the date of this Agreement.

(ee) *Statement of Expenses* shall have the meaning set forth in SECTION 5.4.

(ff) *Stock Consideration* shall mean the number of shares of Parent Common Stock equal to $90,000,000 divided by the Signing Price and rounded down to the nearest whole share.

(gg) *Stockholder* Shall mean any holder of any Company Capital Stock and/or Company Vested Options immediately prior to the Effective Time.

(hh) *Stockholder Arrangements* shall have the meaning set forth in SECTION 5.17.

(ii) *Third Party Expenses* shall have the meaning set forth in SECTION 5.4.

(jj) *Well-Known Seasoned Issuer* shall have the meaning set forth in Rule 405 promulgated by the SEC under the Securities Act.

1.7 *Effect of the Merger on the Capital Stock of the Constituent Corporations.*

(a) *Effect on Capital Stock.* At the Effective Time, by virtue of the Merger and without any action on the part of Sub, the Company or the holders of shares of Company Capital Stock, each outstanding share of Company Capital Stock issued and outstanding immediately prior to the Effective Time (other than Dissenting Shares (as defined in SECTION 1.8(a) hereof)), upon the terms and subject to conditions set forth in this SECTION 1.7 and throughout this Agreement, including, without limitation, the escrow provisions set forth in ARTICLE VII hereof, will be cancelled and extinguished and be converted automatically into the right to receive, upon surrender of the certificate representing such shares of Company Capital Stock in the manner provided in SECTION 1.9 hereof, the portions of the Cash Consideration and the Stock Consideration to be determined in accordance with the provisions set forth in EXHIBIT E attached hereto. Both on the fifth (5th) day prior to the Closing and at the Closing, the Vice President of Finance of the Company shall deliver to Parent a calculation setting forth the portions of the Cash Consideration and the Stock Consideration to which each holder of shares of Company Capital Stock or of vested Company Options, in each case to the extent outstanding on the date such calculation is delivered by the Vice President of Finance of the Company, would be entitled at the Effective Time if such holder were to hold all of such shares of Company Capital Stock or vested Company Options, as the case may be, immediately prior to the Effective Time. Such calculations by the Vice President of Finance of the Company shall be made by implementing the provisions of EXHIBIT E attached hereto.

(b) *Reduction for Escrow Amount.* Each distribution of the Cash Consideration made to a Stockholder pursuant to this SECTION 1.7 shall be reduced by such Stockholder s Pro Rata Portion of the Escrow Amount, if any, in accordance with SECTION 7.4 hereof.

(c) *No Fractional Shares.* No fraction of a share of Parent Common Stock will be issued pursuant to the Merger, but in lieu thereof, each Stockholder who would otherwise be entitled to a fraction of a share of Parent Common Stock (after aggregating all fractional shares of Parent Common Stock to be received by such Stockholder) shall receive from Parent an amount of cash (rounded to the nearest whole cent) equal to the product of (i) such fraction multiplied by (ii) the Signing Price.

(d) Notwithstanding anything in this SECTION 1.7 to the contrary, in no event shall Parent be obligated to distribute in the aggregate (i) cash in excess of the Cash Consideration or (ii) shares of Parent Common Stock in excess of the Stock Consideration.

(e) *Treatment of Company Options.*

(i) No Company Vested Option shall be assumed or otherwise replaced by Parent. Each Company Vested Option shall terminate and cease to be outstanding as of the Effective Time.

(ii) The Company shall give to each holder of a Company Vested Option the opportunity (of not more than 30 days) to decline to accept a modification of such Company Vested Option such that, immediately prior to the Effective Time, and conditioned on the consummation of the Merger, such holder shall automatically (without any further action required of such holder) be deemed to have exercised such Company Vested Option pursuant to a net exercise program whereby such holder will be deemed to have paid the aggregate exercise price for such Company Vested Option by relinquishing that number of shares of Company Common Stock underlying such option in an amount necessary to pay the applicable aggregate exercise price and any applicable withholding taxes associated with such net exercise of such Company Vested Option. The number of shares of Company Common Stock deemed delivered to the holder of each Company Vested Option pursuant to this net exercise program shall be determined by subtracting the Net Exercise Consideration (as defined below) applicable to such Company Vested Option from the number of shares of Company Common Stock subject to such Company Vested Option. The holder of each such Company Vested Option shall from and after the Effective Time (A) participate in the transactions contemplated by this Agreement in the same manner, and to the same extent, as if at the Effective Time such holder owned that number of shares of Company Common Stock delivered after the automatic deemed net exercise pursuant to this Section 1.7(ii) and (B) receive, if applicable, the Fractional Share Payment (as defined below). As soon as practicable following the filing of the Registration Statement and in compliance with applicable securities laws, the Company shall provide to each holder of any Company Option an informational notice and consent describing the treatment of Company Vested Options pursuant to this Section 1.7.

(iii) Parent shall, at its sole discretion and pursuant to a written election of Parent made prior to the Closing, either (A) assume every Company Unvested Option in accordance with the terms set forth below in this Section 1.7(iii) or (B) cause all such Company Unvested Options to vest and terminate (each referred to herein as a CASHED OUT OPTION) and make a cash payment to the holder of each such Cashed Out Option in an amount equal to (x) the number of shares of Company Common Stock underlying all Company Unvested Options held by such holder immediately prior to the Effective Time multiplied by (y) the Per Share Amount and minus (z) the aggregate amount necessary to exercise all of the Company Unvested Options held by such holder. If Parent elects to vest and terminate all Company Unvested Options in accordance with the foregoing provisions of this Section 1.7(iii), Parent shall make the cash payment required pursuant to the foregoing provisions of this Section 1.7(iii) to each holder of Company Unvested Options no later than the second Business Day after the Closing. If Parent elects to assume all Company Unvested Options in accordance with the foregoing provisions of this Section 1.7(iii), (i) each such assumed Company Unvested Option shall thereby be converted into an option (an ASSUMED OPTION) to purchase the number of shares of Parent Common Stock equal to the product of the number of shares of Company Common Stock that were issuable upon exercise of such Company Unvested Option immediately prior to the Effective Time multiplied by the Company Option Exchange Ratio (as defined below), rounded down to the nearest whole number of shares of Parent Common Stock, and (ii) the per share exercise price for the shares of Parent Common Stock issuable upon exercise of such Assumed Option shall be equal to the quotient obtained by dividing the per share exercise price of the Company Unvested Option immediately prior to the Effective Time by the Company Option Exchange Ratio, rounded up to the nearest whole cent. Each Assumed Option shall continue to be subject to the same vesting schedule following the Effective Time as to which it was subject prior to the Effective Time and shall also have the same terms and conditions set forth in the applicable Company Unvested Option (including any applicable award agreement or other documents evidencing such security). Notwithstanding the provisions of the immediately preceding sentence, in the event that, at any time after the Effective Time, Parent or the Surviving Corporation shall terminate for any reason or no reason (other than for Cause) the employment, consultancy or other association of any holder of an Assumed Option, or the holder of any Assumed Option shall terminate for Good Reason his or her employment, consultancy or other association with Parent or the Surviving Corporation, and that at the time of such termination such Assumed Option is not exercisable for all of the shares of Parent Common Stock subject to such Assumed Option, then, immediately upon such termination, such Assumed Option shall automatically (without any further action required by such holder, Parent or the Surviving Corporation) become exercisable for all of the shares of Parent Common Stock subject to such Assumed Option.

(iv) For the purposes of this Section 1.7:

(1) *Cause* shall mean a determination by the Board of Directors of Parent that the holder of an Assumed Option has (a) engaged in willful misconduct or unlawful or dishonest conduct in connection with the performance of such holder s duties and responsibilities as an employee or consultant of Parent or the Surviving Corporation, as the case may be; (b) materially breached any of such holder s obligations under any agreement between such holder and Parent or the Surviving Corporation, as the case may be, that pertains to such holder s employment or consulting relationship with Parent or the Surviving Corporation, as the case may be; (c) been convicted of a felony; or (d) refused to obey or follow a lawful and reasonable directive issued by such holder s direct supervisor.

(2) *Closing Price* shall mean the average of the reported closing price per share of the Parent Common Stock for the ten (10) Business Days prior to the Closing Date.

(3) *Company Option Exchange Ratio* shall mean the quotient obtained by dividing (A) the Per Share Amount by (B) the Closing Price.

(4) *Company Unvested Option* shall mean each Company Option which is not a Company Vested Option.

(5) *Company Vested Option* shall mean each Company Option that is vested and outstanding by its terms immediately prior to the Effective Time (including those that are or become vested by their terms at the Effective Time as a result of the passage of time or transactions contemplated by this Agreement). Company Vested Option shall not include in any event any Company Option vesting solely pursuant to the Parent s election described in Section 1.7(iii) above.

(6) *Fractional Share Payment* shall mean a payment in cash determined by multiplying (A) the fractional share of Company Common Stock which was not required to be paid but was nevertheless forfeited as required by the rounding convention in the definition of Net Exercise Consideration by (B) the Per Share Amount.

(7) *Good Reason* shall mean, with respect to any holder of an Assumed Option, (a) a material change in such holder s position and responsibilities as an employee or consultant of Parent or the Surviving Corporation, as the case may be, except in connection with the termination of such holder s employment with Parent or the Surviving Corporation, as the case may be, (b) a reduction in such holder s base salary or consulting fees not agreed to by such holder, or (c) a material breach by Parent or the Surviving Corporation, as the case may be, of its obligations under any agreement between Parent or the Surviving Corporation, as the case may be, and such holder.

(8) *Net Exercise Consideration* shall mean that number of shares of Company Common Stock determined by dividing (A) the sum of the total aggregate exercise price of the applicable Company Vested Option and the amount of the appropriate tax withholdings in connection with the automatic deemed exercise of such Company Vested Option pursuant to Section 1.7(ii) by (B) the Per Share Amount and then rounding that quotient up to the next whole share.

(9) *Per Share Amount* means an amount determined by dividing (A) the sum of $90,000,000 plus the Cash Consideration by the sum of (B)(i) the total number of shares of Company Common Stock outstanding immediately prior to the Effective Time (without duplication of any of the shares of Company Common Stock referred to in clause (iii) below), (ii) the total number of shares of Company Common Stock issuable immediately prior to the Effective Time upon conversion of all shares of Company Preferred Stock outstanding immediately prior to the Effective Time and (iii) the total number of shares of Company Common Stock issued pursuant to the automatic deemed exercise of Company Vested Options pursuant to Section 1.7(ii) above.

(v) The Company shall use commercially reasonable efforts, prior to the Effective Time, (i) provide any notices to and obtain consents from holders of Company Options and (ii) to amend the terms of its equity incentive plans or arrangements, to give effect to the provisions of this Section 1.7. It is intended that the assumption of the Company Unvested Options by Parent shall comply with Section 424 of the Code. The Company shall take no action, other than those actions contemplated by this Agreement or by any agreement disclosed in the Company Disclosure Statement, which will cause or result in the accelerated vesting of the Company Unvested Options. As soon as practicable after the Effective Time, Parent shall deliver to the holder of each Company Option appropriate notices setting forth the number of shares of Parent Common Stock underlying such Assumed Option then held by each such holder and the exercise price under each such Assumed Option.

(vi) Parent shall take such actions as are necessary for the assumption of the Company Options pursuant to this Section 1.7, including the reservation, issuance and listing of Parent Common Stock as is necessary to effectuate the transactions contemplated by this Section 1.7. Parent shall prepare and file with the SEC a registration statement on Form S-8 with respect to the shares of Parent Common Stock subject to the Company as promptly as practicable and in no event later than ten (10) Business Days after the Effective Time and use commercially reasonable efforts to maintain the effectiveness of such registration statement covering such Company Options for so long as such

Company Options remain outstanding.

(f) *Withholding Taxes.* Notwithstanding any other provision in this Agreement, Parent, the Company, Sub, the Exchange and Paying Agent and Escrow Agent (as defined in SECTION 1.9) shall have the right to deduct and withhold Taxes (as defined in SECTION 2.11) from any payments to be made hereunder if such withholding is required by Law, and to request any necessary Tax forms, including Form W-9 or the appropriate series of Form W-8, as applicable, or any similar information, from the Stockholders and any other recipients of payments hereunder. To the extent that amounts are so withheld, such withheld amounts shall be treated for all purposes of this Agreement as having been delivered and paid to the Stockholder or other recipient of payments in respect of which such deduction and withholding was made.

(g) *Capital Stock of Sub.* Each share of common stock of Sub issued and outstanding immediately prior to the Effective Time shall be converted into and exchanged for one validly issued, fully paid and nonassessable share of common stock of the Surviving Corporation. Each stock certificate of Sub evidencing ownership of any such shares shall continue to evidence ownership of such shares of capital stock of the Surviving Corporation.

(h) *Stockholder Representative Fund.* The Company and the Stockholder Representative hereby, direct Parent that on the Closing Date $200,000 of the Cash Consideration otherwise payable to the Stockholders upon the Closing shall instead be withheld and paid directly by Parent to an account selected by the Stockholder Representative (which prior to the Closing Date shall advise Parent in writing of the details of the account selected), as a fund for the fees and expenses (including legal fees and expenses) of the Stockholder Representative incurred in connection with this Agreement (the STOCKHOLDER REPRESENTATIVE FUND), with any balance of the Stockholder Representative Fund not incurred for such purposes to be returned to the Stockholders when the Stockholder Representative shall deem it appropriate to do so. In the event that the Stockholder Representative Fund shall be insufficient to satisfy the expenses of the Stockholder Representative, and in the event there are any remaining funds in the Escrow Fund to be distributed to the Stockholders immediately prior to the final distribution from the Escrow Fund to the Stockholders pursuant to the Escrow Agreement, the Stockholder Representative shall be entitled to recover any such expenses from the Escrow Fund to the extent of such funds prior to the distribution of funds to the Stockholders. The Stockholders agree that all interest or other income earned from the investment of the Stockholder Representative Fund shall be reported as allocated to the Stockholders in proportion to their interests in the Stockholder Representative Fund. Each Stockholder shall deliver to the Stockholder Representative a properly executed IRS Form W-9 or appropriate IRS Form W-8.

1.8 *Dissenting Shares.*

(a) *Right to Dissent.* Notwithstanding any other provisions of this Agreement to the contrary, any shares of Company Capital Stock held by a holder who has not voted for the Merger, or who has not effectively withdrawn or lost such holder s appraisal rights under Delaware Law (collectively, the DISSENTING SHARES) shall not be converted into or represent a right to receive the applicable consideration for Company Capital Stock set forth in SECTION 1.7 hereof, but the holder thereof shall only be entitled to such rights as are provided by Delaware Law.

(b) *Withdrawal of Appraisal Rights.* Notwithstanding the provisions of SECTION 1.8(a) hereof, if any holder of Dissenting Shares shall effectively withdraw or lose (through failure to perfect or otherwise) such holder s appraisal rights under Delaware Law, then, as of the later of the Effective Time and the occurrence of such event, such holder s shares shall automatically be converted into and represent only the right to receive the consideration for Company Capital Stock, as applicable, set forth in SECTION 1.7 hereof, without interest thereon, upon surrender of the certificate representing such shares.

(c) *Dissenting Share Payments.* The Company shall give Parent and the Stockholder Representative prompt notice of any written demand for appraisal received by the Company pursuant to the applicable provisions of Delaware Law.

Parent shall have the opportunity to participate in (but not control) all negotiations and proceedings with respect to such demands. All such negotiations and proceedings and all decisions related thereto shall be controlled by the Stockholder Representative. None of Parent, the Company or the Surviving Corporation shall, except with the prior written consent of the Stockholder Representative not to be unreasonably withheld, make any payment with respect to any such demands or offer to settle or settle

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any such demands. To the extent that Parent, the Company or the Surviving Corporation (i) makes any payment or payments in respect of any Dissenting Shares in excess of the consideration that otherwise would have been payable in respect of such shares in accordance with this Agreement or (ii) incurs any other costs or expenses, (including specifically, but without limitation, attorneys fees, costs and expenses in connection with any action or proceeding or in connection with any investigation) in respect of any Dissenting Shares (excluding payments for such shares) (together DISSENTING SHARE PAYMENTS), Parent shall be entitled to recover under the terms of SECTION 7.2 hereof the amount of such Dissenting Share Payments without regard to the Deductible or the Basket (as such terms are defined in SECTION 7.5(a) hereof).

1.9 *Surrender of Certificates.*

(a) *Exchange and Paying Agent.* Parent, or an institution selected by Parent, shall serve as the exchange and paying agent (Parent in such capacity, or such institution, the EXCHANGE AND PAYING AGENT) for the Merger to receive the consideration to which the Stockholders are or may be entitled to pursuant to this Agreement.

(b) *Parent to Provide Cash and Parent Common Stock.* Subject to the provisions of SECTION 7.4 relating to escrow arrangements, promptly after the Effective Time, Parent shall make available to the Exchange and Paying Agent for exchange in accordance with this ARTICLE I the shares of Parent Common Stock issuable and the cash payable at the Effective Time pursuant to SECTION 1.7 hereof in exchange for outstanding shares of Company Capital Stock; provided, however, that Parent shall deposit into the Escrow Fund the Escrow Amount out of the Cash Consideration otherwise deliverable to the Stockholders pursuant to SECTION 1.7 hereof. The Pro Rata Portion of the Escrow Amount shall be deemed to be contributed with respect to each Stockholder entitled to receive a portion of the Stock Consideration.

(c) *Exchange Procedures.* Approximately ten (10) days prior to the date the parties expect to be the Closing Date, Parent or the Exchange and Paying Agent shall mail a letter of transmittal to each Stockholder at the address set forth opposite each such Stockholder s name on SECTION 2.2(a) of the Disclosure Schedule. If requested by the Stockholder Representative, Parent or the Exchange and Paying Agent, as the case may be, will include with the letter of transmittal a copy of an agreement between the Stockholder Representative and the Stockholders in the form provided by the Stockholder Representative, with the request that each Stockholder sign and return such agreement with the letter of transmittal; Parent or the Exchange and Paying Agent, as the case may be, will promptly deliver to the Stockholder Representative any such agreements which are returned to Parent or the Exchange and Paying Agent by the Stockholders. At or as soon as practicable following the Closing, the Stockholders will surrender the certificates representing their shares of Company Capital Stock (the COMPANY STOCK CERTIFICATES) to the Exchange and Paying Agent for cancellation together with a duly completed and validly executed letter of transmittal. Upon surrender of a Company Stock Certificate for cancellation to the Exchange and Paying Agent, together with such letter of transmittal, duly completed and validly executed in accordance with the instructions thereto, subject to the terms of SECTION 1.9(f) hereof, the holder of such Company Stock Certificate shall be entitled to receive from the Exchange and Paying Agent in exchange therefor, the applicable portion of the Merger Consideration pursuant to SECTION 1.7 hereof (less the Escrow Amount to be deposited into the Escrow Fund with respect to such Stockholder, if any), and the Company Stock Certificate so surrendered shall be cancelled. Parent shall use commercially reasonable efforts to ensure that, if the Vice President of Finance has delivered to Parent the calculation contemplated under SECTION 1.7(a) hereof at least five (5) days prior to the Closing Date, the Merger Consideration shall be delivered to Stockholders on the Closing Date who have surrendered certificates representing their shares of Company Capital Stock in accordance with the provisions of this SECTION 1.9(c). In the event that, despite using commercially reasonable efforts, Parent is unable to cause the Merger Consideration to delivered to such Stockholders on the Closing Date, Parent shall nevertheless ensure that the Merger Consideration is delivered to such Stockholders within three Business Days after the Closing Date.

(d) Until so surrendered, each Company Stock Certificate outstanding after the Effective Time will be deemed, for all corporate purposes thereafter, to evidence only the right to receive the cash amounts payable and/or Parent Common Stock issuable in exchange for shares of Company Capital Stock (without interest) into which such shares of Company Capital Stock shall have been so converted. No portion of the Merger Consideration will be paid to the holder of any unsurrendered Company Stock Certificate with respect to shares of Company Capital Stock formerly represented thereby until the holder of record of such Company Stock Certificate shall surrender such Company Stock Certificate pursuant hereto.

(e) *Distributions with Respect to Unexchanged Shares.* No dividends or other distributions declared or made after the Effective Time with respect to Parent Common Stock with a record date after the Effective Time will be paid to the holder of any unsurrendered Company Stock Certificate with respect to the shares of Parent Common Stock represented thereby until the holder of record of such Company Stock Certificate shall surrender such Company Stock Certificate. Subject to applicable Laws, following surrender of any such Company Stock Certificate, there shall be paid to the record holder of the certificates representing whole shares of Parent Common Stock issued in exchange therefor, without interest, at the time of such surrender, the amount of dividends or other distributions with a record date after the Effective Time theretofore paid with respect to such whole shares of Parent Common Stock. No interest shall be payable on any cash deliverable upon the exchange of any Company Capital Stock.

(f) *Transfers of Ownership.* If any certificate for shares of Parent Common Stock is to be issued in a name other than that in which the Company Stock Certificate surrendered in exchange therefor is registered, or if any cash amounts are to be disbursed pursuant to SECTION 1.7 hereof to person other than the person whose name is reflected on the Company Stock Certificate surrendered in exchange therefor, it will be a condition of the issuance or delivery thereof that the certificate so surrendered will be properly endorsed and otherwise in proper form for transfer and that the person requesting such exchange will have paid to Parent or any agent designated by it any transfer or other Taxes (as defined in SECTION 2.11) required by reason of the issuance of a certificate for shares of Parent Common Stock in any name other than that of the registered holder of the certificate surrendered, or established to the satisfaction of Parent or any agent designated by it that such Tax has been paid or is not payable.

(g) *Exchange and Paying Agent to Return Cash Consideration.* At any time following the last day of the sixth (6th) month following the Effective Time, Parent shall be entitled to require the Exchange and Paying Agent to deliver to Parent or its designated successor or assign all cash amounts and shares of Parent Common Stock that have been deposited with the Exchange and Paying Agent pursuant to SECTION 1.9(b) hereof, and any and all interest thereon or other income or proceeds thereof, not disbursed to the holders of Company Stock Certificates pursuant to SECTION 1.9(b) hereof, and thereafter the holders of Company Stock Certificates shall be entitled to look only to Parent (subject to the terms of SECTION 1.9(h) hereof) only as general creditors thereof with respect to any and all amounts that may be payable to such holders of Company Stock Certificates pursuant to SECTION 1.7 hereof upon the due surrender of such Company Stock Certificates in the manner set forth in SECTION 1.9(b) hereof.

(h) *No Liability.* Notwithstanding anything to the contrary in this SECTION 1.9, neither the Exchange and Paying Agent, the Surviving Corporation, nor any party hereto shall be liable to a holder of shares of Company Capital Stock for any amount properly paid to a public official as required by any applicable abandoned property, escheat or similar Law.

1.10 *No Further Ownership Rights in Company Capital Stock.* The cash amounts paid and Parent Common Stock issued in respect of the surrender for exchange of shares of Company Capital Stock in accordance with the terms hereof shall be deemed to be full satisfaction of all rights pertaining to such shares of Company Capital Stock, and there shall be no further registration of transfers on the records of the Surviving Corporation of shares of Company Capital Stock that were outstanding immediately prior to the Effective Time. If, after the Effective Time, Company Stock Certificates are presented to the Surviving Corporation for any reason, they shall be canceled and exchanged as provided in this ARTICLE I.

1.11 *Lost, Stolen or Destroyed Certificates.* In the event any Company Stock Certificates shall have been lost, stolen or destroyed, the Exchange and Paying Agent shall issue in exchange for such lost, stolen or destroyed certificates, upon the making of an affidavit of that fact by the holder thereof, such amount, if any, as may be required pursuant to SECTION 1.7 hereof; provided, however, that Parent may, in its discretion and as a condition precedent to the issuance thereof, require the Stockholder who is the owner of such lost, stolen or destroyed certificates to either (i) deliver a bond in such amount as it may reasonably direct or (ii) provide an unsecured indemnification agreement in a form and substance reasonably acceptable to Parent, against any claim that may be made against Parent or the Exchange and Paying Agent with respect to the certificates alleged to have been lost, stolen or destroyed.

1.12 *Taking of Necessary Action; Further Action.* If at any time after the Effective Time, any further action is necessary or desirable to carry out the purposes of this Agreement and to vest the Surviving Corporation with full right, title and possession to all assets, property, rights, privileges, powers and franchises of the Company, Parent, Sub, and the officers and directors of the Company, Parent and Sub are fully authorized in the name of their respective corporations or otherwise to take, and will take, all such lawful and necessary action.

ARTICLE II

REPRESENTATIONS AND WARRANTIES OF THE COMPANY

The Company hereby represents and warrants to Parent and Sub, subject to such exceptions as are disclosed in the disclosure schedule supplied by the Company to Parent (as supplemented pursuant to SECTION 5.15 hereof, the DISCLOSURE SCHEDULE) and dated as of the date hereof, on the date hereof and as of the Effective Time, as though made at the Effective Time, as follows:

The Disclosure Schedule is numbered and captioned to correspond to the Sections in this Article II. Each disclosure in the Disclosure Schedule qualifies the representations and warranties in the corresponding Section of this Article II and any other Section(s) of this Article II to which such disclosure is cross-referenced or with respect to which the relevance of such disclosure is reasonably apparent on its face.

2.1 *Organization of the Company.* The Company is a corporation duly organized, validly existing and in good standing under the Laws of the State of Delaware. The Company has the corporate power to own its properties and to carry on its business as currently conducted. The Company is duly qualified or licensed to do business and in good standing as a foreign corporation in each jurisdiction in which the failure to be so qualified or licensed would have a Company Material Adverse Effect. The Company has delivered a true and correct copy of its certificate of incorporation and bylaws, each as amended to date and in full force and effect on the date hereof (collectively, the CHARTER DOCUMENTS), to Parent. SECTION 2.1 of the Disclosure Schedule lists the directors and officers of the Company as of the date hereof. SECTION 2.1 of the Disclosure Schedule also lists (i) each jurisdiction in which the Company is qualified or licensed to do business and (ii) every state or foreign jurisdiction in which the Company has Employees or facilities or otherwise carries on business.

2.2 *Company Capital Structure.*

(a) The authorized capital stock of the Company consists of 128,000,000 shares of Common Stock, of which 17,363,169 shares are issued and outstanding and 80,084,844 shares of Preferred Stock, of which 5,600,000 shares have been designated Series A Convertible Preferred Stock, all of which are issued and outstanding, 1,820,000 shares have been designated Series B Convertible Preferred Stock, all of which are issued and outstanding, 6,383,294 shares have been designated Series C Convertible Preferred Stock, all of which are issued and outstanding and 66,281,550 shares have been designated Series D Convertible Preferred Stock, all of which are issued and outstanding. The Company Capital Stock is held by the persons with the domicile addresses and in the amounts set forth in SECTION 2.2(a) of the Disclosure Schedule. All outstanding shares of Company Capital Stock are duly authorized, validly issued, fully paid and non-assessable and not subject to preemptive rights created by statute, the Charter Documents, or any Contract to which the Company is a party or by which it is bound, and have been issued in compliance in all material respects with federal and state securities Laws. All outstanding shares of Company Capital

Stock and Company Options have been issued or repurchased (in the case of shares that were outstanding and repurchased by the Company or any stockholder of the Company) in compliance in all material respects with all applicable Laws, including federal and state securities Laws. The Company has not, and will not have, suffered or incurred any Liability (as defined in SECTION 2.8), contingent or otherwise, or claim, loss, damage, deficiency, cost or expense relating to or arising out of the issuance or repurchase of any Company Capital Stock or Company Options, or out of any Contracts relating thereto (including any amendment of the terms of any such arrangement or arrangements). There are no declared or accrued but unpaid dividends with respect to any shares of Company Capital Stock. The Company has no capital stock other than the Company Common Stock and the Company Preferred Stock authorized, issued or outstanding. The Company has no Company Capital Stock that is unvested.

(b) Except for the Plans, the Company has never adopted, sponsored or maintained any stock option plan or any other plan or agreement providing for equity compensation to any person. The Company has reserved 24,727,315 shares of Company Common Stock for issuance to employees and directors of, and consultants to, the Company upon the issuance of stock or the exercise of Company Options granted under the Plans or any other plan, Contract or arrangement (whether written or oral, formal or informal), of which (i) 20,110,890 shares are issuable, as of the date hereof, upon the exercise of outstanding, unexercised Company Options, and (ii) 1,903,169 shares have been issued upon the exercise of Company Options previously granted as of the date hereof. Except for the Company Options set forth in SECTION 2.2(b) of the Disclosure Schedule (such schedule to contain, for each holder of Company Options, the name and address of such holder, the number of Company Options held by such holder, the vesting schedule and exercise price of such Company Options, the dates on which such Company Options were granted and will expire, the number of shares vested under such Company Options and whether any Company Options are intended to be incentive stock options under the Code), there are no options, warrants, calls, rights, convertible securities, commitments or Contracts of any character to which the Company is a party or by which the Company is bound obligating the Company to issue, deliver, sell, repurchase or redeem, or cause to be issued, delivered, sold, repurchased or redeemed, any shares of the Company Capital Stock or obligating the Company to grant, extend, accelerate the vesting of, change the price of, otherwise amend or enter into any such option, warrant, call, right, commitment or agreement. There are no outstanding or authorized stock appreciation, phantom stock, profit participation, or other similar rights with respect to the Company. Except as contemplated hereby, there are no voting trusts, proxies, or other Contracts or understandings with respect to the voting stock of the Company. There are no Contracts to which the Company is a party relating to the registration, sale or transfer (including agreements relating to rights of first refusal, co-sale rights or drag-along rights) of any Company Capital Stock. As a result of the Merger, Parent will be the sole record and beneficial holder of all issued and outstanding Company Capital Stock and all rights to acquire or receive any shares of Company Capital Stock, whether or not such shares of Company Capital Stock are outstanding. SECTION 2.2(b) of the Disclosure Schedule lists any Company Options, the vesting of which will accelerate as of the Effective Time as result of the Merger or which may be subject to acceleration following the Effective Time (whether or not such acceleration is conditioned upon the occurrence of a subsequent event).

2.3 *Subsidiaries.* The Company does not have and has never had any subsidiaries or affiliated companies and does not otherwise own and has never otherwise owned any shares of capital stock or any interest in, or control, directly or indirectly, any other corporation, limited liability company, partnership, association, joint venture or other business entity. The Company has not agreed, is not obligated to make, or is not bound by any Contract under which it may become obligated to make any future investment in, or capital contribution to, any other entity. The Company does not directly or indirectly own any equity or similar interest in or any interest convertible, exchangeable or exercisable for any equity or similar interest in, any person.

2.4 *Authority.* The Company has all requisite power and authority to enter into this Agreement and any Related Agreements to which it is a party and (subject to the Sufficient Stockholder Vote) to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement and any Related Agreements to which the Company is a party and (subject to the Sufficient Stockholder Vote) the consummation of the transactions contemplated hereby and thereby have been duly authorized by all necessary corporate action on the part of the Company and no further action (other than the Sufficient Stockholder Vote) is required on the part of the Company to authorize the Agreement and any Related Agreements to which it is a party and the transactions contemplated hereby and thereby. The vote required under Delaware Law and the Charter Documents to approve this Agreement by the

Stockholders is set forth in SECTION 2.4 of the

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Disclosure Schedule (SUFFICIENT STOCKHOLDER VOTE). This Agreement and the Merger have been unanimously approved by the Board of Directors of the Company. This Agreement has been duly executed and delivered by the Company and assuming the due authorization, execution and delivery by the other parties hereto, this Agreement constitutes, and each of the Related Agreements to which the Company is contemplated to be a party, if and when duly executed and delivered by the Company will constitute, the valid and binding obligations of the Company enforceable against it in accordance with their respective terms, except as such enforceability may be subject to the laws of general application relating to bankruptcy, insolvency, and the relief of debtors and rules of law governing specific performance, injunctive relief, or other equitable remedies.

2.5 *No Conflict.* The execution and delivery by the Company of this Agreement and any Related Agreement to which the Company is a party, and (subject to the Sufficient Stockholder Vote) the consummation of the transactions contemplated hereby and thereby, will not conflict with or result in any violation of or default under (with or without notice or lapse of time, or both) or give rise to a right of termination, cancellation, modification or acceleration of any obligation or loss of any benefit under (i) any provision of the Charter Documents, (ii) any Material Contract (as defined in SECTION 2.15), or (iii) any Law applicable to the Company or any of its properties (whether tangible or intangible) or assets, except in the case of clause (iii) for such violations or failures to comply as have not had or are not reasonably likely to have a Company Material Adverse Effect.

2.6 *Consents.* No consent, notice, waiver, approval, order or authorization of, or registration, declaration or filing with any court, administrative agency or commission or other federal, state, county, local or other foreign governmental or regulatory authority, instrumentality, agency or commission (each, a GOVERNMENTAL ENTITY), is required by the Company in connection with the execution and delivery of this Agreement and any Related Agreements to which the Company is a party or the consummation of the transactions contemplated hereby and thereby, except for compliance with the pre-merger notification requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the HSR ACT), and under the comparable non-U.S. competition Laws the parties reasonably determine apply.

2.7 *Company Financial Statements.*

(a) SECTION 2.7 of the Disclosure Schedule sets forth the Company s (i) unaudited consolidated balance sheet as of December 31, 2006 (the BALANCE SHEET DATE), and audited consolidated balance sheets as of December 31, 2005 and December 31, 2004, and the related consolidated statements of income, cash flow and stockholders equity for each of the twelve (12) month periods then ended (the YEAR-END FINANCIALS), and (ii) unaudited consolidated balance sheet as of March 31, 2007, and the related unaudited consolidated statements of income, cash flow and stockholders equity for the three (3) month period then ended (the INTERIM FINANCIALS). The Year-End Financials and the Interim Financials (collectively referred to as the FINANCIALS) have been prepared in accordance with GAAP consistently applied on a consistent basis throughout the periods indicated and consistent with each other (except that unaudited Financials do not contain footnotes and other presentation items that may be required by GAAP). The Financials present fairly the Company s financial condition, operating results and cash flows as of the dates and during the periods indicated therein, subject in the case of the Interim Financials, to normal year-end adjustments that are not material in amount or significance in any individual case or in the aggregate. The Company s unaudited consolidated balance sheet as of the Balance Sheet Date is referred to hereinafter as the CURRENT BALANCE SHEET.

(b) Any financial statements provided by the Company pursuant to SECTION 5.13 hereof, when delivered, will (i) have been derived from the books and records of the Company, (ii) fairly present, in all material respects, the consolidated financial position, results of operations and cash flows of the Company at the dates and for the periods indicated in accordance with GAAP and Regulation S-X promulgated under the Exchange Act (REGULATION S-X).

2.8 *No Undisclosed Liabilities.* The Company has no liability, indebtedness, obligation, expense, claim, deficiency, guaranty or endorsement of any type, whether accrued, absolute, contingent, matured, unmatured or other (LIABILITIES), other than (i) Liabilities reflected in the Current Balance Sheet, or

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incurred in the ordinary course of business, consistent with past practice, and not required by GAAP to be set forth in a balance sheet, (ii) Liabilities arising in the ordinary course of business consistent with past practices since the Balance Sheet Date, (iii) Liabilities for fees and expenses incurred in connection with the transactions contemplated by this Agreement, and (iv) Liabilities that, in the aggregate, are immaterial to the financial condition or operating results of the Company and its subsidiaries, taken as a whole.

2.9 *Internal Controls.* The Company maintains books and records reflecting its assets and Liabilities and maintains internal accounting controls that the Company reasonably believes provide reasonable assurance that (i) transactions are executed with management s authorization; (ii) transactions are recorded as necessary to permit preparation of the consolidated financial statements of the Company in accordance with GAAP and to maintain accountability for the Company s consolidated assets; (iii) access to the Company s assets is permitted only in accordance with management s authorization; (iv) the identification of the Company s assets is compared with existing assets as necessary to permit preparation of the consolidated financial statements of the Company in accordance with GAAP and to maintain accountability for the Company s consolidated assets; (v) accounts, notes and other receivables and inventory are recorded accurately, and adequate procedures are implemented to effect the collection thereof on a timely basis; and (vi) there are adequate procedures in place regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company s assets. As of the date of this Agreement, to the Company s Knowledge, (x) there are no significant deficiencies in the design or operation of the Company s internal controls over financial reporting that could reasonably be expected to adversely affect in any material respect the Company s ability to record, process, summarize and report financial data or material weaknesses in internal controls over financial reporting and (y) there has been no fraud, whether or not material, that involved management or other employees of the Company who have a significant role in the Company s internal controls over financial reporting.

2.10 *No Changes.* From the Balance Sheet Date through the date of this Agreement, there has not been, occurred or arisen any:

(a) transaction by the Company except in the ordinary course of business as conducted on that date and consistent with past practices;

(b) capital expenditure or commitment by the Company exceeding $100,000 individually or $250,000 in the aggregate;

(c) payment, discharge or satisfaction, in any amount in excess of $50,000 in any one case, or $100,000 in the aggregate, of any Liabilities, other than payments, discharges or satisfactions in the ordinary course of business, consistent with past practices, of Liabilities reflected or reserved against in the Current Balance Sheet;

(d) destruction of, damage to, or loss of any material assets (whether tangible or intangible), material business or material customer of the Company (whether or not covered by insurance);

(e) change in accounting methods or practices (including any change in depreciation or amortization policies or rates) by the Company other than as required by GAAP;

(f) adoption of or change in any material Tax (as defined below) election, adoption of or change in any Tax accounting method, entry into any closing agreement, settlement or compromise of any Tax claim or assessment, or extension or waiver of the limitation period applicable to any Tax claim or assessment;

(g) material revaluation by the Company of any of its assets (whether tangible or intangible), including without limitation, writing down the value of inventory or writing off notes or accounts receivable;

(h) increase in the salary or other compensation payable or to become payable by the Company to any of its respective officers, directors, Employees or advisors, which increase (individually or in the aggregate) is material to the Company, or the declaration, payment or commitment or obligation of any kind for the payment (whether in cash or equity) by the Company of a severance payment, termination payment, bonus or other additional salary or compensation to any such person;

(i) incurring by the Company of any indebtedness for borrowed money, amendment of the terms of any outstanding loan agreement, guaranteeing by the Company of any material indebtedness, issuance or sale of any debt securities, purchase of a material amount of debt securities or guaranteeing of any debt securities of others, except for advances to employees for travel and business expenses in the ordinary course of business, consistent with past practices;

(j) waiver or release of any rights or claims of the Company, including any write-offs or other compromise of any account receivable of the Company, with a value in excess of $25,000 individually or $50,000 in the aggregate;

(k) commencement or settlement of any lawsuit by the Company, the commencement, settlement, notice or, to the Knowledge of the Company, threat of any lawsuit or proceeding or other investigation against the Company (other than on the part of Parent or any of its affiliates, as to which this representation is not made);

(l) receipt by the Company of written notice of any claim or potential claim of ownership, interest or right by any person other than the Company of the Company Intellectual Property (as defined in SECTION 2.14 hereof) or of infringement by the Company of any other person s Intellectual Property (as defined in SECTION 2.14 hereof);

(m) (i) except standard end user licenses/hosting agreements entered into in the ordinary course of business, consistent with past practice, sale or license of any Company Intellectual Property or execution, modification or amendment of any agreement with respect to the Company Intellectual Property with any person or with respect to the Intellectual Property of any person, or (ii) except in the ordinary course of business, consistent with past practice, purchase or license of any Intellectual Property or execution, modification or amendment of any agreement with respect to the Intellectual Property of any person, (iii) agreement or modification or amendment of an existing agreement with respect to the development of any Intellectual Property with a third party, or (iv) material change in pricing or royalties set or charged by the Company to its customers or licensees or in pricing or royalties set or charged by persons who have licensed Intellectual Property to the Company;

(n) event or condition of any character that has had or is reasonably likely to have a Company Material Adverse Effect; or

(o) agreement by the Company, or any officer or employees on behalf of the Company, to do any of the things described in the preceding clauses (a) through (m) of this SECTION 2.10 (other than negotiations with Parent and its representatives regarding the transactions contemplated by this Agreement and the Related Agreements).

2.11 *Tax Matters.*

(a) *Definition of Taxes.* For the purposes of this Agreement, the term TAX or, collectively, TAXES shall mean any and all U.S. federal, state, local and non-U.S. taxes, assessments, duties, impositions and other governmental charges, including taxes based upon or measured by gross receipts, income, profits, sales, use and occupation, and value added, ad valorem, transfer, franchise, withholding, payroll, recapture, employment, excise and property taxes as well as public imposts, fees and social security charges (including but not limited to health, unemployment and pension insurance), together with all interest, penalties and additions imposed with respect to such amounts.

(b) *Tax Returns and Audits.*

(i) The Company has (a) prepared and timely filed all material U.S. federal, state, local and non-U.S. returns, estimates, information statements and reports (RETURNS) relating to any and all Taxes of the Company and such Returns are true and correct in all material respects and have been completed in accordance with applicable Laws and (b) timely paid all Taxes it is required to pay (whether or not shown to be due on any Return).

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(ii) The Company has paid or withheld with respect to its Employees (as defined in SECTION 2.22) and other third parties, all U.S. federal, state and non-U.S. income taxes and social security charges and similar fees, Federal Insurance Contribution Act amounts, Federal Unemployment Tax Act amounts and other Taxes it was required to withhold, and has timely paid over any such withheld Taxes to the appropriate authorities.

(iii) There is no Tax deficiency outstanding, assessed or proposed against the Company, nor has the Company executed any outstanding waiver of any statute of limitations on or extending the period for the assessment or collection of any Tax.

(iv) To the Company s Knowledge, no audit or other examination of any Return of the Company is presently in progress, nor has the Company been notified of any request for such an audit or other examination. No adjustment relating to any Return filed by the Company has been proposed by any Tax authority to the Company or any representative thereof. No claim has ever been made to the Company in writing by an authority in a jurisdiction where the Company does not file Returns that it is or may be subject to taxation by that jurisdiction.

(v) The Company has not incurred any Liability for Taxes since the Balance Sheet Date other than in the ordinary course of business.

(vi) The Company has made available to Parent or its legal counsel, copies of all Returns for the Company filed for the past six (6) years.

(vii) There are (and immediately following the Effective Time there will be) no Liens on the assets of the Company relating to or attributable to Taxes, other than Liens for Taxes not yet due and payable.

(viii) None of the Company s assets is treated as tax-exempt use property, within the meaning of Section 168(h) of the Code.

(ix) The Company has (a) never been a member of an affiliated group (within the meaning of Code Section 1504(a)) filing a consolidated federal income tax Return, (b) never been a party to any Tax sharing, indemnification, allocation or similar agreement, (c) no liability for the Taxes of any person under Treasury Regulation Section 1.1502-6 (or any similar provision of state, local or foreign Law (including any arrangement for group or consortium relief or similar arrangement)), as a transferee or successor, or by Contract (other than Contracts entered into with customers, vendors or real property lessors, the principal purpose of which is not to address Tax matters) and (d) never been a party to any joint venture, partnership or other arrangement that could be treated as a partnership for Tax purposes.

(x) The Company has not been, at any time, a United States Real Property Holding Corporation within the meaning of Section 897(c)(2) of the Code.

(xi) The Company has not constituted either a distributing corporation or a controlled corporation in a distribution of stock intended to qualify for tax-free treatment under Section 355 of the Code.

(xii) The Company has not engaged in a reportable transaction under Treas. Reg. Section 1.6011-4(b), including a transaction that is the same as or substantially similar to one of the types of transactions that the Internal Revenue Service has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction, as set forth in Treas. Reg. Section 1.6011-4(b)(2).

(xiii) The Company will not be required to include any income or gain or exclude any deduction or loss from Taxable income in any Tax Period ending after the Effective Time as a result of any (a) change in method of accounting under

Section 481 of the Code, (b) closing agreement under Section 7121 of the Code, (or in the case of each of (a) and (b), under any similar provision of applicable Laws), or (c) prepaid amount.

(xiv) The Company is not subject to Tax in any jurisdiction outside of the United States by virtue of having a permanent establishment or other place of business or by virtue of having a source of income in that country.

(xv) The Company is in full compliance with all terms and conditions of any currently effective Tax exemption, Tax holiday or other Tax reduction agreement or order applicable to it (TAX INCENTIVE) and the consummation of the transactions contemplated by this Agreement will not have any adverse effect on the continued validity and effectiveness of any such Tax Incentive.

(c) *Executive Compensation Tax.* There is no Contract to which the Company is a party, including, without limitation, the provisions of this Agreement, covering any Employee of the Company, that, individually or collectively, could give rise to the payment of any amount that would not be deductible pursuant to Sections 280G or 404 of the Code or that would give rise to a penalty under Section 409A of the Code.

(d) *409A.* The Company is not party to any Contract that is a nonqualified deferred compensation plan subject to Section 409A of the Code. Each such nonqualified deferred compensation plan has been operated since January 1, 2005 in good faith compliance with Section 409A of the Code and IRS Notice 2005-1. No nonqualified deferred compensation plan has been materially modified (within the meaning of IRS Notice 2005-1) at any time after October 3, 2004. No Company Option, Company Warrant or other right to acquire Company Common Stock or other equity of the Company (i) has an exercise price that has been or may be less than the fair market value of the underlying equity as of the date such Company Option, Company Warrant or other right was granted, (ii) has any feature for the deferral of compensation other than the deferral of recognition of income until the later of exercise or disposition of such Company Option, Company Warrant or rights, or (iii) has been granted after December 31, 2004, with respect to any Company Capital Stock that is not service recipient stock (within the meaning of applicable regulations under Section 409A).

2.12 *Restrictions On Business Activities.* There is no Contract, commitment, judgment, injunction, order or decree to which the Company is a party or otherwise binding upon the Company that has or may reasonably be expected to have the effect of prohibiting or impairing any business practices of the Company, any acquisition of property (tangible or intangible) by the Company, the conduct of business by the Company, or otherwise limiting the freedom of the Company to engage in any line of business or to compete with any person. Without limiting the generality of the foregoing, the Company has not entered into any Contract under which the Company is restricted from selling, licensing, manufacturing or otherwise distributing any of its technology or products or from providing services to customers or potential customers, in any geographic area, during any period of time, or in any segment of the market.

2.13 *Title To Properties; Absence Of Liens And Encumbrances; Condition Of Equipment.*

(a) The Company does not own any real property, nor has the Company ever owned any real property. SECTION 2.13(a) of the Disclosure Schedule sets forth a list of all real property currently leased, subleased or licensed by or from the Company or otherwise used or occupied by the Company for the operation of its business (the LEASED REAL PROPERTY), the name of the lessor, licensor, sublessor, master lessor and/or lessee, the date and term of the lease, license, sublease or other occupancy right and each amendment thereto (the LEASE AGREEMENTS) and, with respect to any current lease, license, sublease or other occupancy right, the aggregate annual rent payable thereunder. All such Lease Agreements are valid and effective in accordance with their respective terms, and there is not, under any of such leases, any existing default, past due rent, or event of default (or event which with notice or lapse of time, or both, would constitute a default on) on the part of the Company, or to the Company s Knowledge, on the part of any other party thereto. The Company has not received any notice of a default, alleged failure to perform, or any offset or counterclaim with respect to any such Lease Agreement, that has not been fully remedied and withdrawn.

(b) To the Company s Knowledge, the Leased Real Property is in good operating condition and repair, free from structural, physical and mechanical defects and is structurally sufficient and otherwise suitable for the conduct of the business as presently conducted. Neither the operation of the Company on the Leased Real Property nor, to the Company s Knowledge, such Leased Real Property, including the improvements thereon, violate in any material respect any applicable building code, zoning requirement or Law relating to such property or operations thereon, and any such non-violation is not dependent on so-called non-conforming use exceptions.

(c) The Company has good and valid title to, or, in the case of leased properties and assets, valid leasehold interests in, all of its tangible properties and assets, real, personal and mixed, used or held for use in

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its business, free and clear of any Liens, except (i) as reflected in the Current Balance Sheet, (ii) Liens for Taxes not yet due and payable, and (iii) such imperfections of title and encumbrances, if any, which do not detract from the value or interfere with the present use of the property subject thereto or affected thereby.

(d) All facilities, equipment and other properties owned, leased or used by the Company are (i) adequate for the conduct of the business of the Company as currently conducted and as currently contemplated to be conducted (such contemplation evidenced by a resolution of the Company s board of directors) and (ii) to the Company s Knowledge, in good operating condition, regularly and properly maintained, subject to normal wear and tear.

2.14 *Intellectual Property.*

(a) *Definitions.* For all purposes of this Agreement, the following terms shall have the following respective meanings:

Intellectual Property shall mean any or all of the following (i) works of authorship including, without limitation, computer programs, source code, and executable code, whether embodied in software, firmware or otherwise, architecture, documentation, designs, files, records, databases, and data, (ii) inventions (whether or not patentable), discoveries, improvements, and technology, (iii) proprietary and confidential information, trade secrets and know how,

(iv) databases, data compilations and collections and technical data, (v) domain names, web addresses and sites, (vi) tools, methods and processes, and (vii) any and all instantiations or embodiments of the foregoing in any form and embodied in any media.

Intellectual Property Rights shall mean worldwide common law and statutory rights associated with (i) patents and patent applications of any kind, (ii) copyrights, copyright registrations and copyright applications, moral rights and mask work rights, (iii) the protection of trade and industrial secrets and confidential information, (iv) other proprietary rights relating to intangible Intellectual Property, (v) logos, trademarks, trade names and service marks, (vi) analogous rights to those set forth above, and (vii) divisions, continuations, renewals, reissuances and extensions of the foregoing (as applicable).

Company Intellectual Property shall mean any and all Intellectual Property and Intellectual Property Rights that are owned by or exclusively licensed to the Company.

Registered Intellectual Property shall mean Intellectual Property and Intellectual Property Rights that have been registered, applied for, filed, certified or otherwise perfected, issued, or recorded with or by any state, government or other public or quasi-public legal authority.

(b) Section 2.14(b) of the Disclosure Schedule (i) lists all Registered Intellectual Property owned by, or filed in the name of, the Company (the COMPANY REGISTERED INTELLECTUAL PROPERTY) and (ii) lists any material proceedings or actions before any court, tribunal (including the United States Patent and Trademark Office (the PTO) or equivalent authority anywhere in the world) related to any of the Company Registered Intellectual Property or Company Intellectual Property.

(c) Each item of Company Registered Intellectual Property is valid and subsisting, and all necessary registration, maintenance and renewal fees have been paid and all necessary documents and certificates required to be filed in connection with such Company Registered Intellectual Property have been filed with the relevant patent, copyright, trademark or other authorities in the United States or foreign jurisdictions, as the case may be, for the purposes of maintaining such Registered Intellectual Property. In each case in which the Company has acquired title to any Intellectual Property or Intellectual Property Rights from any person, the Company has obtained an assignment in form sufficient to irrevocably transfer all rights in such Intellectual Property and the associated Intellectual Property Rights.

(d) All Company Intellectual Property will be fully transferable and licensable by the Surviving Corporation and/or Parent without restriction and without payment of any kind to any third party.

(e) Each item of Company Intellectual Property is free and clear of any Liens.

(f) The Company has not (i) transferred ownership of, or granted any exclusive license of or exclusive right to use, or authorized the retention of any exclusive rights to use or joint ownership of, any Intellectual Property or Intellectual Property Rights that is or was Company Intellectual Property, to any other person or (ii) permitted the Company s rights in any Company Intellectual Property to enter into the public domain.

(g) The Company Intellectual Property constitutes all of the Intellectual Property and Intellectual Property Rights used in, necessary to or otherwise would be infringed by the conduct of the business of the Company as it currently is conducted, including, without limitation, the design, development, marketing, manufacture, use, import and sale of any product, technology or service currently being produced and sold by the Company. The Surviving Corporation will own or possess sufficient rights to all Intellectual Property and Intellectual Property Rights immediately following the Closing Date that are necessary to the operation of the business of the Company as it currently is conducted and without infringing on the Intellectual Property Rights of any person. For avoidance of doubt, currently as it is used in this SECTION 2.14(g), when measured as of the Closing Date, shall mean both at the Effective Time and immediately following the Effective Time .

(h) No third party that has licensed Intellectual Property or Intellectual Property Rights to the Company has ownership rights or license rights to improvements or derivative works made by the Company in such Intellectual Property that has been licensed to the Company.

(i) Section 2.14(i) of the Disclosure Schedule lists all Contracts between the Company and any other person wherein or whereby the Company has agreed to, or assumed, any obligation or duty to warrant, indemnify, reimburse, hold harmless, guaranty or otherwise assume or incur any obligation or Liability or provide a right of rescission with respect to the infringement or misappropriation by the Company, or such other person of the Intellectual Property Rights of any person other than the Company, but excluding (i) Shrink-Wrap Code and (ii) non-disclosure agreements entered into in the ordinary course of business.

(j) The operation of the business of the Company as it has been conducted and is currently conducted by the Company, including but not limited to the design, development, use, import, branding, advertising, promotion, marketing, distribution, manufacture and sale of any product, technology or service that has been or is being produced and sold by the Company has not infringed or misappropriated, does not infringe or misappropriate, and will not infringe or misappropriate when conducted by Parent and/or the Surviving Corporation following the Closing in the manner currently conducted, any Intellectual Property Rights of any person, violate any privacy, publicity, or similar right or constitute unfair competition or trade practices under the Laws of any jurisdiction. Except for such notices both (a) for which Company has provided complete copies to Parent s legal counsel (along with all related information Known to Company and reasonably requested by Parent s legal counsel) and (b) that include claims of infringement or misappropriation that would not, individually or in the aggregate, result in liability to the Company of more than one million dollars ($1,000,000) or result (either directly or indirectly as a result of an injunction or other order (whether temporary, preliminary or permanent)) in a loss of more than one percent (1%) of the Company s annual revenues, the Company has not received notice from any person claiming that such operation or any act, any product, technology or service (including products, technology or services currently under development) or Intellectual Property of the Company infringes or misappropriates any Intellectual Property Rights of any person or constitutes unfair competition or trade practices under the Laws of any applicable jurisdiction (nor does the Company have Knowledge of any basis therefor). For avoidance of doubt, currently as it is used in this SECTION 2.14(j), when measured as of the Closing Date, shall mean both at the Effective Time and immediately following the Effective Time .

(k) Neither this Agreement nor the transactions contemplated by this Agreement, including the assignment (or deemed assignment) to Parent and/or the Surviving Corporation by operation of law or otherwise of any Contracts to which the Company is a party, will result in (other than by reason of agreements entered into by Parent or any of its subsidiaries or other actions taken by any of them): (i) Parent or any of its subsidiaries granting to any third party any right to or with respect to any Intellectual Property Rights owned by, or licensed to Parent or any of its subsidiaries, (ii) Parent or any of its subsidiaries, being bound by or subject to, any exclusivity obligations, non-compete or other restriction on the operation or scope of their respective businesses, or (iii) Parent or the Surviving Corporation being obligated to pay any royalties or other material amounts to any third party in excess of those payable by any of them, respectively, in the absence of this Agreement or the transactions contemplated hereby.

(l) To the Knowledge of the Company, no person has infringed or misappropriated or is infringing or misappropriating any Company Intellectual Property.

(m) The Company has, and enforces, a policy requiring each Employee and contractor to execute proprietary information, confidentiality and assignment agreements substantially in the Company s standard forms (in the forms set forth in EXHIBIT C), and all current and former Employees and contractors of the Company have executed such an agreement in substantially the Company s standard form. To the extent that any Intellectual Property has been developed or created independently or jointly by any person other than the Company for which the Company has, directly or indirectly, provided consideration for such development or creation, the Company has a written Contract with such person with respect thereto pursuant to the terms of which such person agrees that the Company thereby has obtained ownership of all rights (or where not assignable, a waiver of all nonassignable rights) of such person with respect to all such Intellectual Property therein and associated Intellectual Property Rights.

(n) No Company Intellectual Property, Intellectual Property Rights, product, technology, or service of the Company is subject to any pending proceeding (other than the Parent/Company Litigation, as to which no representation is made) or outstanding decree, order, judgment or settlement agreement or stipulation that restricts in any manner the use, transfer or licensing thereof by the Company or may affect the validity, use or enforceability of such Company Intellectual Property.

(o) No government funding, facilities or resources of a university, college, other educational institution or research center or funding from third parties was used in the development of the Company Intellectual Property and no Governmental Entity, university, college, other educational institution or research center has any claim or right in or to the Company Intellectual Property. To the Company s Knowledge, no current or former Employee or independent contractor of the Company who was involved in, or who contributed to, the creation or development of any Company Intellectual Property, has performed services for the government, a university, college or other educational institution, or a research center, during a period of time during which such Employee or independent contractor was also performing services for the Company.

(p) The Company has complied in all material respects with all applicable Laws and its own internal privacy policies, if any, relating to the privacy of users of its products, services, and Web sites, and also the collection, storage, and transfer of any personally identifiable information collected by or on behalf of the Company.

(q) The Company has taken commercially reasonable steps to protect the Company s rights in confidential information and trade secrets of the Company or provided by any other person to the Company. Without limiting the foregoing, neither the Company nor any person acting on the Company s behalf has disclosed, delivered or licensed to any person, agreed to disclose, deliver or license to any person, or permitted the disclosure or delivery to any escrow agent or other person of any source code or related proprietary or confidential information or algorithms owned by the Company or used in its business (COMPANY SOURCE CODE). No event has occurred, and no circumstance or condition exists, that (with or without notice or lapse of time or both) will, or would reasonably be expected to, result in the disclosure or delivery by or on behalf of the Company of any Company Source Code.

(r) SECTION 2.14(r) of the Disclosure Schedule lists all software or other material that is distributed as freeware, free software, open source software or under a similar licensing or distribution model (including but not limited to the GNU General Public License) that the Company uses or licenses, and identifies that which is incorporated into, combined with, or distributed in conjunction with any Company products (INCORPORATED OPEN SOURCE

SOFTWARE) and identifies the type of license or distribution model governing its use. The Company s use and/or distribution of each component of Incorporated Open Source Software complies with all material provisions of the applicable license agreement, and in no case does such use or distribution give rise under such license agreement to any rights in any third parties under any Company Intellectual Property or obligations for the Company with respect to any Company Intellectual Property, including without limitation any obligation to disclose or distribute any such Intellectual Property in source code form, to license any such Intellectual Property for the purpose of making derivative works, or to distribute any such Intellectual Property without charge.

(s) Notwithstanding any other provision of this Agreement to the contrary, the Company makes no representations or warranties, and affirmatively disclaims any and all representations and warranties, relating to infringement or misappropriation (or Liabilities or other consequences thereof) or lack thereof (i) of any Intellectual Property Rights that the Parent or any of its affiliates owns or has the right to enforce, or (ii) with respect to products other than the products that the Company has produced and sold to customers or is currently producing and selling to customers.

2.15 *Agreements, Contracts and Commitments.*

(a) The Company is not a party to, nor is it bound by any of the following under which any party thereto has or may have any remaining obligation or liability (whether accrued, absolute, contingent, matured, unmatured or otherwise) (each, a MATERIAL CONTRACT):

(i) any employment or consulting Contract or commitment with an Employee or consultant or salesperson, or consulting or sales Contract, or commitment with a firm or other organization requiring annual payments in excess of $100,000;

(ii) any Contract or plan, including, without limitation, any stock option plan, stock appreciation rights plan or stock purchase plan, any of the benefits of which will be increased, or the vesting of benefits of which will be accelerated, by the occurrence of any of the transactions contemplated by this Agreement (either alone or upon the occurrence of any additional subsequent events) or the value of any of the benefits of which will be calculated on the basis of any of the transactions contemplated by this Agreement;

(iii) any fidelity or surety bond or completion bond;

(iv) any lease of personal property having a value in excess of $25,000 individually or $50,000 in the aggregate and any Lease Agreement;

(v) any agreement of indemnification or guaranty under which the Company s has actual or potential liability that exceeds $25,000 individually or $50,000 in the aggregate;

(vi) any Contract or commitment relating to capital expenditures and involving future payments in excess of $100,000 individually or $250,000 in the aggregate;

(vii) any Contract or commitment relating to the uncompleted disposition or acquisition of assets or any interest in any business enterprise outside the ordinary course of the Company s business;

(viii) any mortgages, indentures, guarantees, loans or credit agreements, security agreements or other agreements or instruments relating to the borrowing of money or extension of credit;

(ix) any purchase order or Contract for the purchase of materials involving in excess of $25,000 individually or $50,000 in the aggregate;

(x) any Contract containing covenants or other obligations granting or containing any current or future commitments regarding exclusive rights, non-competition, most favored nations, restriction on the operation or scope of its businesses or operations, or similar terms;

(xi) any dealer, distribution or marketing Contract requiring or reasonably anticipated to result in payments by any party thereto in excess of $25,000 annually or $50,000 in the aggregate;

(xii) any development, joint venture, partnership or similar Contract;

(xiii) any sales representative, original equipment manufacturer, manufacturing, value added, remarketer, reseller, or independent software vendor, or other Contract for use or distribution of the products, technology or services of the Company;

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(xiv) any customer Contract involving, or reasonably expected to involve revenues to the Company in excess of $25,000 annually or $50,000 in the aggregate;

(xv) any agreement that is royalty bearing or any Contract with respect to any Intellectual Property or Intellectual Property Rights, including without limitation, any cross licenses, but excluding (i) non-exclusive in-licenses and purchase agreements for commercial off-the-shelf Intellectual Property that are generally available on nondiscriminatory pricing terms, in the case of software for a cost of not more than $5,000 for a perpetual license for a single user or work station or $50,000 in the aggregate for all users and work stations (SHRINK-WRAP CODE) and (ii) non-disclosure agreements entered into in the ordinary course of business; or

(xvi) any other Contract or commitment that involves the payment or receipt by the Company of $25,000 individually or $50,000 in the aggregate or more and is not cancelable without penalty within thirty (30) days.

(b) The Company is in compliance in all material respects with and has not materially breached, materially violated or defaulted under, or received written notice that it has breached, violated or defaulted under, any Material Contract, nor does the Company have Knowledge of any event that would constitute such a breach, violation or default with the lapse of time, giving of notice or both. Each Material Contract is in full force and effect and to the Knowledge of the Company no other party obligated to the Company pursuant to any such Material Contract has materially breached, materially violated or defaulted under any such Material Contract. SECTION 2.15 of the Disclosure Schedule sets forth all necessary consents, waivers and approvals of parties to any Material Contracts as are required thereunder in connection with the Merger, or for any such Material Contract to remain in full force and effect without limitation, modification or alteration after the Effective Time so as to preserve all rights of, and benefits to, the Company under such Material Contracts from and after the Effective Time. SECTION 2.15 of the Disclosure Schedule identifies each Material Contract which by its terms will terminate or may be terminated by either party thereto, solely by the passage of time or at the election of either party. Following the Effective Time, the Surviving Corporation will be permitted to exercise all of its rights under the Material Contracts without the payment of any additional amounts or consideration other than ongoing fees, royalties or payments which the Company would otherwise be required to pay pursuant to the terms of such Material Contracts had the transactions contemplated by this Agreement not occurred.

2.16 *Interested Party Transactions.* To the Company s Knowledge, no officer, director or Stockholder of the Company (nor any ancestor, sibling, descendant or spouse of any of such persons, or any trust, partnership or corporation in which any of such persons has or has had an interest), has or has had, directly or indirectly, (i) an interest in any entity that furnished or sold or licensed, or furnishes or sells or licenses, services, products, technology or Intellectual Property that the Company furnishes or sells, or proposes to furnish or sell, or (ii) any interest in any entity that purchases from or sells or furnishes to the Company, any goods or services, or (iii) a beneficial interest in any Material Contract to which the Company is a party; provided, however, that ownership of no more than one percent (1%) of the outstanding voting stock of a publicly traded corporation shall not be deemed to be an interest in any entity for purposes of this SECTION 2.16. No Stockholder has any loans outstanding from the Company.

2.17 *Governmental Authorization.* Each consent, license, permit, grant or other authorization (i) pursuant to which the Company currently operates or holds any interest in any of its properties, or (ii) that is required for the operation of the Company s business as currently conducted or currently contemplated to be conducted (such contemplation evidenced by a resolution of the Company s board of directors) or the holding of any such interest (collectively, COMPANY AUTHORIZATIONS) has been issued or granted to the Company, as the case may be, and the Company Authorizations are in full force and effect and constitute all Company Authorizations required to permit the Company to operate or conduct its business or hold any interest in its properties or assets, except where the failure of the Company to have such Company Authorizations or for such Company Authorizations to be in full force and effect have not had or are not reasonably likely to have (individually or in the aggregate) a Company Material Adverse

Effect.

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2.18 *Litigation.* There is no material action, suit, claim or proceeding of any nature pending, or to the Knowledge of the Company, threatened, against the Company, its properties (tangible or intangible) or any of its officers or directors (other than the Parent/Company Litigation, as to which no representation or warranty is made). There is no investigation or other proceeding pending or, to the Knowledge of the Company, threatened, against the Company, any of its properties (tangible or intangible) or any of its officers or directors by or before any Governmental Entity (other than the Parent/Company Litigation, as to which no representation or warranty is made). No Governmental Entity has at any time challenged the legal right of the Company to conduct its operations as presently or previously conducted or as presently contemplated to be conducted (such contemplation evidenced by a resolution of the Company s board of directors).

2.19 *Minute Books.* The minute books of the Company made available to counsel for Parent contain records of all material actions taken, and summaries of all meetings held, by the Stockholders and the Board of Directors of the Company (and any committees thereof) since the time of incorporation of the Company, and such minute books are complete and accurate in all material respects.

2.20 *Environmental Matters.* The Company has complied with all applicable Laws enacted for the protection of the environment (including, without limitation, air, water vapor, surface water, groundwater and soils) against contamination with hazardous substances or wastes, except where failure to comply has not had or is not reasonably likely to have a Company Material Adverse Effect.

2.21 *Brokers and Finders Fees; Third Party Expenses.* The Company has not incurred, nor will it incur, directly or indirectly, any Liability for brokerage or finders fees or agents commissions, fees related to investment banking or similar financial advisory services or any similar charges in connection with the Agreement or any transaction contemplated hereby.

2.22 *Employee Benefit Plans and Compensation.*

(a) *Definitions.* For all purposes of this Agreement, the following terms shall have the following respective meanings:

Erisa Affiliate shall mean any other person under common control with the Company within the meaning of Section 414(b), (c), (m) or (o) of the Code, and the regulations issued thereunder.

Company Employee Plan shall mean any plan, program, policy, practice, Contract or other arrangement providing for compensation, severance, termination pay, deferred compensation, retirement benefits, performance awards, stock or stock-related awards, fringe benefits or other employee benefits or remuneration of any kind, whether written, unwritten or otherwise, funded or unfunded, including without limitation, each employee benefit plan, within the meaning of Section 3(3) of ERISA that is or has been maintained, contributed to, or required to be contributed to, by the Company or any ERISA Affiliate for the benefit of any Employee, or with respect to which the Company or any ERISA Affiliate has or may have any liability or obligation.

Cobra shall mean the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended.

Dol shall mean the United States Department of Labor.

Employee shall mean any current or former employee, consultant or director of the Company or any ERISA Affiliate.

Employee Agreement shall mean each management, employment, severance, consulting, relocation, repatriation, expatriation, visa, work permit or other Contract (including, without limitation, any offer letter or any Contract providing for acceleration of Company Options or Company Common Stock that is unvested, or any other agreement providing for compensation or benefits) between the Company or any ERISA Affiliate and any Employee and that the Company or any ERISA Affiliate has or may have any Liability or obligation.

Erisa shall mean the Employee Retirement Income Security Act of 1974, as amended.

International Employee Plan shall mean each Company Employee Plan or Employee Agreement that has been adopted or maintained by the Company or any ERISA Affiliate, whether formally or informally or with respect to which the Company or any ERISA Affiliate will or may have any liability with respect to Employees who perform services outside the United States.

IRS shall mean the United States Internal Revenue Service.

PBGC shall mean the United States Pension Benefit Guaranty Corporation.

Pension Plan shall mean each Company Employee Plan that is an employee pension benefit plan, within the meaning of Section 3(2) of ERISA.

(b) *Schedule.* SECTION 2.22(b)(1) of the Disclosure Schedule contains an accurate and complete list of each Company Employee Plan and each Employee Agreement. The Company has not made any plan or commitment to establish any new Company Employee Plan or Employee Agreement, to modify any Company Employee Plan or Employee Agreement (except to the extent required by Law or to conform any such Company Employee Plan or Employee Agreement to the requirements of any applicable Laws, in each case as previously disclosed to Parent in writing, or as required by this Agreement), or to enter into any Company Employee Plan or Employee Agreement. SECTION 2.22(b)(2) of the Disclosure Schedule sets forth a table setting forth the name, salary and bonus compensation of each Employee of the Company.

(c) *Documents.* The Company has provided to Parent (i) correct and complete copies of all documents embodying each Company Employee Plan and each Employee Agreement including, without limitation, all amendments thereto and all related trust documents, (ii) the three (3) most recent annual reports (Form Series 5500 and all schedules and financial statements attached thereto), if any, required under ERISA or the Code in connection with each Company Employee Plan, (iii) if the Company Employee Plan is funded, the most recent annual and periodic accounting of Company Employee Plan assets, (iv) the most recent summary plan description together with the summary(ies) of material modifications thereto, if any, required under ERISA with respect to each Company Employee Plan, (v) all material written Contracts relating to each Company Employee Plan, including, without limitation, administrative service agreements and group insurance contracts, (vi) all communications material to any Employee or Employees relating to any Company Employee Plan and any proposed Company Employee Plans, in each case, relating to any amendments, terminations, establishments, increases or decreases in benefits, acceleration of payments or vesting schedules or other events that would result in any material Liability to the Company, (vii) all correspondence to or from any governmental agency relating to any Company Employee Plan, (viii) model COBRA forms and related notices, (ix) all policies pertaining to fiduciary liability insurance covering the fiduciaries for each Company Employee Plan, (x) all discrimination tests for each Company Employee Plan for the three (3) most recent plan years, and (xi) the most recent IRS determination or opinion letter issued with respect to each Company Employee Plan.

(d) *Employee Plan Compliance.* The Company has, in all material respects, performed all obligations required to be performed by it under each Company Employee Plan, is not in default or violation of, and has no Knowledge of any default or violation by any other party to each Company Employee Plan, and each Company Employee Plan has been established and maintained, in all material respects, in accordance with its terms and compliance with all applicable Laws, including but not limited to ERISA or the Code. Any Company Employee Plan intended to be qualified under Section 401(a) of the Code has obtained a favorable determination letter (or opinion letter valid as to the Company, if applicable) with respect to all Tax Law changes prior to the Economic Growth and Tax Relief Reconciliation Act of 2001 as to its qualified status under the Code. No prohibited transaction, within the meaning of Section 4975 of the Code or Sections 406 and 407 of ERISA, and not otherwise exempt under Section 4975 of the Code or Section 408 of ERISA, has occurred with respect to any Company Employee Plan. There are no actions, suits or claims pending or, to the Knowledge of the Company, threatened or reasonably anticipated (other than routine claims for benefits) against any Company Employee Plan or against the assets of any Company Employee Plan. Each Company Employee Plan can be amended, terminated or otherwise discontinued after the Effective Time in accordance with its terms, without liability to Parent, the Company or any ERISA Affiliate (other than ordinary administration expenses and/or reasonable notice periods). There are no audits, inquiries or proceedings pending or to the Knowledge of the Company or any ERISA Affiliates, threatened by the IRS, DOL, or any other Governmental Entity with respect to any Company Employee Plan. Neither the Company nor any ERISA Affiliate is subject to any penalty or Tax with respect to any Company Employee Plan under Section 502(i) of ERISA or Sections 4975 through 4980 of the Code. The Company has timely made all contributions and other payments required by and due under the terms of each Company Employee Plan.

(e) *No Pension Plans.* Neither the Company nor any current or past ERISA Affiliate has ever maintained, established, sponsored, participated in, or contributed to, any Pension Plans subject to Title IV of ERISA or Section 412 of the Code.

(f) *No Self-Insured Plans.* Neither the Company nor any ERISA Affiliate has ever maintained, established sponsored, participated in or contributed to any self-insured plan that provides benefits to Employees (including, without limitation, any such plan pursuant to which a stop-loss policy or Contract applies).

(g) *Collectively Bargained, Multiemployer And Multiple-Employer Plans.* At no time has the Company or any current or past ERISA Affiliate contributed to or been obligated to contribute to any Pension Plan, that is a Multiemployer Plan, as defined in Section 3(37) of ERISA. Neither the Company nor any ERISA Affiliate has at any time ever maintained, established, sponsored, participated in or contributed to any multiple employer plan or to any plan described in Section 413 of the Code.

(h) *No Post-Employment Obligations.* No Company Employee Plan or Employee Agreement provides, or reflects or represents any Liability to provide, retiree life insurance, retiree health or other retiree employee welfare benefits to any person for any reason, except as may be required by COBRA or other applicable statute, and the Company has never represented, promised or contracted (whether in oral or written form) to any Employee (either individually or to Employees as a group) or any other person that such Employee(s) or other person would be provided with retiree life insurance, retiree health or other retiree employee welfare benefits, except to the extent required by statute.

(i) *Effect Of Transaction.* The execution of this Agreement and the consummation of the transactions contemplated hereby will not (either alone or upon the occurrence of any additional or subsequent events) constitute an event under any Company Employee Plan, Employee Agreement, trust or loan that will or may result in any payment (whether of severance pay or otherwise), acceleration, forgiveness of indebtedness, vesting, distribution, increase in benefits or obligation to fund benefits with respect to any Employee.

(j) *Section 280g.* No payment or benefit which has been, will be or may be made by the Company or any ERISA Affiliates with respect to any Employee will, or could reasonably be expected to, be characterized as a parachute payment, within the meaning of Section 280G(b)(2) of the Code as a result of the transactions contemplated by this Agreement. There is no Contract, plan or arrangement to which the Company or any ERISA Affiliate is a party or by which the Company or any ERISA Affiliate is bound to compensate any Employee for excise taxes paid pursuant to Section 4999 of the Code. SECTION 2.22(j) of the Disclosure Schedule lists all persons who are disqualified individuals (within the meaning of Section 280G of the Code and the regulations promulgated thereunder) as determined as of the date hereof.

(k) *Employment Matters.* The Company is in compliance in all material respects with all applicable Laws respecting employment, employment practices, terms and conditions of employment, employee safety and wages and hours, and in each case, with respect to Employees: (i) has withheld and reported all amounts required by Law or by Contract to be withheld and reported with respect to wages, salaries and other payments to Employees, (ii) is not liable for any arrears of wages or severance pay (other than routine, non-material payments to be made in the ordinary course of business, consistent with past practice) or any Taxes or any penalty for failure to comply with any of the foregoing, and (iii) is not liable for any payment to any trust or other fund governed by or maintained by or on behalf of any

Governmental Entity, with respect to unemployment compensation benefits, social security or other benefits or obligations for Employees (other than routine payments to be made in the normal course of business and consistent with past practice). There are no action, suits, claims or administrative matters pending or threatened against the Company or any of its Employees relating to any Employee, Employee Agreement or Company Employee Plan. There are no pending or threatened claims or actions against Company or any Company trustee under any worker s compensation policy. The services provided by each of the Company s and its ERISA Affiliates Employees is terminable at the will of the Company and its ERISA Affiliates and any such termination would result in no Liability to the Company or any ERISA Affiliate. Neither the Company nor any ERISA Affiliate has direct or indirect liability with respect to any misclassification of any person as an independent contractor rather than as an employee, or with respect to any Employee leased from another employer.

(l) *Labor.* No work stoppage or labor strike against the Company is pending, or to the Knowledge of the Company, threatened. The Company does not know of any activities or proceedings of any labor union to organize any Employees. There are no actions, suits, claims, labor disputes or grievances pending or threatened relating to any labor matters involving any Employee, including, without limitation, charges of unfair labor practices. The Company has not engaged in any unfair labor practices within the meaning of the National Labor Relations Act. The Company is not presently, nor has it been in the past, been a party to, or bound by, any collective bargaining agreement or union Contract with respect to Employees and no collective bargaining Contract is being negotiated by the Company.

(m) *No Interference Or Conflict.* To the Knowledge of the Company, no Stockholder, director, officer or Employee of the Company is obligated under any Contract, subject to any judgment, decree, or order of any court or administrative agency that would interfere with such person s responsibilities to promote the interests of the Company. Neither the execution nor delivery of this Agreement, nor the carrying on of the Company s business as presently conducted or proposed to be conducted nor any activity of such Stockholder, director, officer or Employee in connection with the carrying on of the Company s business as presently conducted or currently proposed to be conducted will, to the Knowledge of the Company, violate or result in a breach of, or constitute a default under, any Contract under which any of such Stockholder, director, officer or Employee is now bound.

(n) *International Employee Plan.* Neither the Company nor any ERISA Affiliate currently or has it ever had the obligation to maintain, establish, sponsor, participate in, be bound by or contribute to any International Employee Plan.

2.23 *Insurance.* SECTION 2.23 of the Disclosure Schedule lists all material insurance policies and fidelity bonds covering the assets, business, equipment, properties, operations, Employees, officers and directors of the Company, including the type of coverage, the carrier, the amount of coverage, the term and the annual premiums of such policies. There is no claim by the Company pending under any of such policies or bonds as to which coverage has been questioned, denied or disputed or that the Company has a reason to believe will be denied or disputed by the underwriters of such policies or bonds. In addition, there is no pending claim of which its total value (inclusive of defense expenses) will exceed the policy limits. All premiums due and payable under all such policies and bonds have been paid, (or if installment payments are due, will be paid if incurred prior to the Closing Date) and the Company is otherwise in material compliance with the terms of such policies and bonds. Such policies and bonds remain in full force and effect. The Company has no Knowledge of threatened termination of, or premium increase with respect to, any of such policies. The Company has never maintained, established, sponsored, participated in or contributed to any self-insurance plan. Notwithstanding the foregoing, no representation is made with respect to insurance (including with respect to the existence of coverage, or terms thereof) in respect of or relating to the Parent/Company Litigation.

2.24 *Compliance With Laws.* The Company has not received any notices of violation with respect to any Laws except for such violations as have not had and are not reasonably likely to have a Company Material Adverse Effect.

2.25 *Bank Accounts, Letters Of Credit And Powers Of Attorney.* SECTION 2.25 of the Disclosure Schedule lists (a) all bank accounts, lock boxes and safe deposit boxes relating to the business and operations of the Company (including the name of the bank or other institution where such account or box is located and the name of each authorized signatory thereto), (b) all outstanding letters of credit issued by financial institutions for the account of the

Company (setting forth, in each case, the financial institution issuing such letter of credit, the maximum amount available under such letter of credit, the terms (including the expiration date) of such letter of credit and the party or parties in whose favor such letter of credit was issued), and (c) the name and address of each person who has a power of attorney to act on behalf of the Company. The Company has heretofore delivered to Parent true, correct and complete copies of each letter of credit and each power of attorney described in SECTION 2.25 of the Disclosure Schedule.

2.26 *Information Supplied.* None of the information supplied in writing by the Company specifically for inclusion or incorporation by reference, and which in fact is included or incorporated by reference in (i) the Registration Statement will, at the time the Registration Statement or any amendment or supplement becomes effective, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances under which they were made, and (ii) the information provided to Stockholders in the Soliciting Materials will, at the time they are mailed to the Stockholders and at all times during which stockholder consents are solicited in connection with the Merger, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein not misleading in light of the circumstances under which they are made.

2.27 *Disclaimer Of Certain Representations And Warranties.* The Company makes no representations or warranties and affirmatively disclaims any and all representations and warranties relating to the Parent/Company Litigation, including with respect to the merit or lack thereof of such (a) Parent/Company Litigation, or claims relating to Liabilities or other consequences of such Parent/Company Litigation or (b) relating to infringement or misappropriation by the Company or its Affiliates of any Intellectual Property Rights that either (i) the Parent or any of its Affiliates (excluding Company) owns.

ARTICLE III

REPRESENTATIONS AND WARRANTIES OF PARENT AND SUB

Each of Parent and Sub hereby represents and warrants to the Company subject to such exceptions as are disclosed in the disclosure schedule supplied by Parent to the Company (the PARENT DISCLOSURE SCHEDULE) and dated as of the date hereof, on the date hereof and as of the Effective Time, as though made at the Effective Time, as follows:

The Parent Disclosure Schedule is numbered and captioned to correspond to the Sections in this Article III. Each disclosure in the Parent Disclosure Schedule qualifies the representations and warranties in the corresponding Section of this Article III and any other Section(s) of this Article III to which such disclosure is cross-referenced or with respect to which the relevance of such disclosure is reasonably apparent on its face.

3.1 *Organization, Standing And Power.* Parent is a corporation duly organized, validly existing and in good standing under the Laws of the State of Delaware. Sub is a corporation duly organized, validly existing and in good standing under the Laws of Delaware. Each of Parent and Sub has the corporate power to own its properties and to carry on its business as now being conducted and is duly qualified or licensed to do business and is in good standing in each jurisdiction in which the failure to be so qualified or licensed would have or be reasonably likely to have a Parent Material Adverse Effect.

3.2 *Authority.* Each of Parent and Sub has all requisite corporate power and authority to enter into this Agreement and any Related Agreements to which it is a party and to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement and any Related Agreements to which it is a party and the consummation of the transactions contemplated hereby and thereby have been duly authorized by all necessary corporate action on the part of Parent and Sub. This Agreement and any Related Agreements to which Parent and Sub are parties have been duly executed and delivered by Parent and Sub and constitute the valid and binding obligations of Parent and Sub, enforceable against each of Parent and Sub in accordance with their terms, except as such enforceability may be limited by principles of public policy and subject to the laws of general application relating to bankruptcy, insolvency and the relief of debtors and rules of law governing specific performance, injunctive relief or other equitable remedies.

3.3 *Parent Capital Structure.*

(a) The authorized capital stock of Parent consists of: (A) 560,000,000 shares of Parent Common Stock, par value $0.001 per share and (B) 40,000,000 shares of preferred stock, par value $0.001 per share, of which (x) 100,000 shares have been designated as Series A Preferred Stock (the PARENT SERIES A PREFERRED STOCK) and (y) 15,000,000 shares have been designated as Series B Preferred Stock (the PARENT SERIES B PREFERRED STOCK). At the close of business on April 30, 2007: (i) 176,390,889 shares of Parent Common Stock were issued and outstanding, excluding shares of Parent Common Stock held by Parent in its treasury, (ii) 3,132,119 shares of Parent Common Stock were issued and held by Parent in its treasury, (iii) no shares of Parent Series A Preferred Stock were issued and outstanding, (iv) 3,562,238 shares of Parent Series B Preferred Stock were issued and outstanding and (v) not more than 18,470,116 shares of Parent Common Stock were reserved for issuance upon exercise of outstanding employee and director stock options to purchase shares of Parent Common Stock. No shares of Parent Common Stock are owned or held by any subsidiary of Parent. All of the outstanding shares of capital stock of Parent are, and all shares of capital stock of Parent which may be issued as contemplated or permitted by this Agreement will be, when issued, duly authorized and validly issued, fully paid and nonassessable and not subject to any preemptive rights. There are no declared or accrued but unpaid dividends with respect to any shares of capital stock of Parent.

(b) Except as set forth above and as set forth in Section 3.3(b) of the Parent Disclosure Schedule, as of the close of business on April 30, 2007, there are no securities, options, warrants, calls, rights, commitments, agreements, arrangements or undertakings of any kind to which Parent or any of its subsidiaries is a party or by which any of them is bound obligating Parent or any of its subsidiaries to issue, deliver or sell, or cause to be issued, delivered or sold, additional shares of capital stock or other voting securities of Parent or any of its subsidiaries or obligating Parent or any of its subsidiaries to issue, grant, extend or enter into any such security, option, warrant, call, right, commitment, agreement, arrangement or undertaking. As of the close of business on April 30, 2007, there are not any outstanding contractual obligations of Parent or any of its subsidiaries to repurchase, redeem or otherwise acquire any shares of capital stock of Parent or any of its subsidiaries.

(c) The authorized capital stock of Sub consists of 1,000 shares of common stock, par value $0.001 per share, of which 1,000 shares are issued and outstanding. Parent is the sole stockholder of Sub and is the legal and beneficial owner of all 1,000 issued and outstanding shares. Sub was formed by counsel to Parent at the direction of Parent, solely for purposes of effecting the Merger and the other transactions contemplated hereby. Except as contemplated by this Agreement, Sub does not hold, nor has it held, any material assets or incurred any material liabilities nor has Sub carried on any business activities other than in connection with the Merger and the transactions contemplated by this Agreement.

3.4 *No Conflict.* The execution and delivery by Parent and Sub of this Agreement and any Related Agreement to which Parent or Sub is a party, and the consummation of the transactions contemplated hereby and thereby, will not conflict with or result in any violation of or default (with or without notice of lapse of time, or both) under (i) the certificate of incorporation and bylaws of Parent or Sub, each as amended to date and in full force and effect on the date hereof, or (ii) assuming compliance with the matters referred to in SECTION 3.5, any Laws applicable to Parent or any of its properties (whether tangible or intangible) or assets, except in the case of clause (ii) for such violations or defaults as have not had or are not reasonably likely to have a Parent Material Adverse Effect.

3.5 *Consents.* No consent, waiver, approval, order or authorization of, or registration, declaration or filing with, any Governmental Entity, is required by or with respect to Parent or Sub in connection with the execution and delivery of this Agreement and any Related Agreements to which Parent or Sub is a party or the consummation of the transactions contemplated hereby and thereby, except for (i) the filing of the Registration Statement (ii) such consents, waivers, approvals, orders, authorizations, registrations, declarations and filings as may be required under applicable securities

Laws, (iii) compliance with the pre-merger notification requirements of the HSR Act and under comparable non-U.S. competition Laws the parties reasonably determine apply, (iv) such consents, waivers, approvals, orders, authorizations, registrations, declarations and filings which, if not obtained or made, would not have, or be reasonably likely to have a

Parent Material Adverse Effect, and (v) the filing of the Certificate of Merger with the Secretary of State of the State of Delaware.

3.6 *Capital Resources; Solvency.* Parent has sufficient capital resources available to pay the Cash Consideration. Consummation of the Merger and the other transactions contemplated by this Agreement will not cause Parent to become insolvent. The fair value of the property of Parent exceeds its total liabilities (including contingent liabilities but without duplication of any underlying liability related thereto). The present fair saleable value on a going-concern basis of Parent s assets is not less than the amount required to pay its probable liabilities on its debts as they become absolute and mature. Parent does not intend to, and does not believe that it will, incur debts or liabilities beyond its ability to pay as such debts and liabilities mature. Parent is not engaged in business or a transaction for which its property would constitute unreasonably small capital.

3.7 *Parent Common Stock.* The Parent Common Stock that constitutes the Stock Consideration has been duly authorized, and upon consummation of the transactions contemplated by this Agreement, will be validly issued, fully paid and nonassessable and will be issued without violation of applicable Laws. Upon consummation of the transaction contemplated by this Agreement, the Parent Common Stock that constitutes the Stock Consideration will have been duly registered pursuant to the Securities Act, will not constitute restricted securities within the meaning of that term as defined in Rule 144(a)(3) promulgated by the SEC under the Securities Act, and will be freely resaleable by the Stockholders without registration under the Securities Act, subject only, in the case of any Stockholder who is an affiliate of the Company as of the Effective Time, to any applicable restrictions imposed by Rule 145 promulgated by the SEC under the Securities Act.

3.8 *Sec Documents.* Parent has filed all required registration statements, prospectuses, reports, schedules, forms, statements and other documents (including exhibits and all other information incorporated by reference) required to be filed by it with the SEC since January 1, 2005. Parent has made available to the Company all such registration statements, prospectuses, reports, schedules, forms, statements and other documents in the form filed with the SEC. All such required registration statements, prospectuses, reports, schedules, forms, statements and other documents (including those that Parent may file subsequent to the date hereof until the Effective Time) are referred to herein as the PARENT SEC REPORTS. As of their respective dates, the Parent SEC Reports (i) were prepared in accordance and complied in all material respects with the requirements of the Securities Act, or the Exchange Act, as the case may be, and the rules and regulations of the SEC thereunder applicable to such Parent SEC Reports and (ii) did not at the time they were filed (or if amended or superseded by a filing prior to the date of this Agreement then on the date of such filing) contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading. None of Parent s subsidiaries is required to file any forms, reports or other documents with the SEC. As of the date hereof, Parent is a Well-Known Seasoned Issuer.

3.9 *Parent Financial Statements.* The financial statements of Parent included in the Parent SEC Reports comply as to form in all material respects with applicable accounting requirements and the published rules and regulations of the SEC with respect thereto, have been prepared in accordance with GAAP (except, in the case of unaudited statements, as permitted by Form 10-Q of the SEC) applied on a consistent basis throughout the periods indicated (except as may be indicated in the notes thereto) and fairly present the consolidated financial position of Parent and its consolidated subsidiaries as of the dates thereof and the consolidated results of their operations and cash flows for the periods then ended (subject, in the case of unaudited statements to normal year-end adjustments).

3.10 *No Undisclosed Liabilities.* Parent has no material obligations or liabilities of any nature (whether accrued, absolute, contingent or otherwise) other than (i) those set forth or adequately provided for in the balance sheet included in Parent s most recently filed Quarterly Report on Form 10-Q (including the notes thereto, the PARENT BALANCE SHEET), (ii) those incurred in the ordinary course of business, consistent with past practice, and not required by GAAP to be set forth in the Parent Balance Sheet, (iii) those that, individually or in the aggregate, have not had, and would not reasonably be expected to have a Parent Material

Adverse Effect or (iv) those incurred in the ordinary course of business since the date of the Parent Balance Sheet, consistent with past practice.

3.11 *Absence Of Certain Changes Or Events.* Except as disclosed in the Parent SEC Reports, since the date of the most recent unaudited financial statements included in the Parent SEC Reports and through the date of this Agreement, there has not been (i) any Parent Material Adverse Effect, (ii) any declaration, setting aside or payment of any dividend or other distribution (whether in cash, stock or property) with respect to any of Parent s capital stock, (iii) any amendment of any provision of the certificate of incorporation or bylaws of, or of any material term of any outstanding security issued by, Parent, (iv) any material change in any method of accounting or accounting practice by Parent except for any such change required by a change in GAAP or (v) any split, combination or reclassification of any of its capital stock or any issuance or the authorization of any issuance of any other securities in respect of, in lieu of, or in substitution for shares of its capital stock.

3.12 *Interim Operations Of Sub.* Sub was formed solely for the purpose of engaging in the transactions contemplated by this Agreement and have engaged in no business activities other than as contemplated by this Agreement.

3.13 *Information Supplied.* The Registration Statement on Form S-4 to be filed by Parent to register the issuance of the Parent Common Stock to be issued in the Merger (the REGISTRATION STATEMENT) (excluding any of the information supplied in writing by the Company specifically for inclusion or incorporation by reference therein, as to which no representation or warranty is made) will not, at the time the Registration Statement or any amendment or supplement thereto becomes effective, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances under which they were made, (ii) the proxy statement included in the Registration Statement, as provided to Stockholders in the Soliciting Materials (excluding any of the information supplied in writing by the Company specifically for inclusion or incorporation by reference therein, as to which no representation or warranty is made) will not, at the time the Soliciting Materials are mailed to the Stockholders and at all times that stockholder consents or votes are being solicited in connection with the Merger, including at any stockholder meeting held to obtain such consents or vote, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein not misleading in light of the circumstances under which they are made.

3.14 *Litigation.* Except as disclosed in the Parent SEC Reports filed prior to the date of this Agreement, there is no action, suit, claim or proceeding of any nature pending, or to the Knowledge of Parent, threatened, against Parent, any of its subsidiaries, their respective properties (tangible or intangible) or any of their respective officers or directors, that could result in a Parent Material Adverse Effect, and there is no investigation or similar proceeding pending or, to the Knowledge of Parent, threatened, against Parent by or before the SEC or Nasdaq. No Governmental Entity has at any time challenged the legal right of Parent or any of its subsidiaries to conduct its operations as presently or previously conducted.

ARTICLE IV

CONDUCT PRIOR TO THE EFFECTIVE TIME

4.1 *Conduct Of Business Of The Company.* Subject to the last sentence of this SECTION 4.1, during the period from the date of this Agreement and continuing until the earlier of the termination of this Agreement or the Effective Time, the Company agrees to conduct its business, except to the extent that Parent shall otherwise consent in writing, which consent will not be unreasonably withheld, in the usual, regular and ordinary course in substantially the same manner as heretofore conducted, to pay the debts and Taxes of the Company when due (subject to SECTION 4.1(e) below), to pay or perform other obligations when due, and, to the extent consistent with such business, to preserve intact the present business organizations of the Company, to use commercially reasonable efforts to keep available the services of the present officers and key employees of the Company and preserve the relationships of the Company with customers, suppliers, distributors, licensors, licensees, and others having business dealings with them, all with the goal of preserving unimpaired the goodwill and ongoing businesses of the Company at the Effective Time. The Company shall use commercially reasonable efforts to promptly notify Parent of any event or occurrence or emergency not in the ordinary course of business of the Company and any material event involving the Company that arises during the period from the date of this Agreement and continuing until the earlier of the termination date of this Agreement or the Effective Time; provided, however, that no failure of the Company to notify Parent of any such event or occurrence or emergency shall constitute a breach of the covenant contained in this sentence unless such event, occurrence or emergency, individually or in the aggregate, has caused or could reasonably be expected to cause a Company Material Adverse Effect or to cause any of the conditions to Parent s obligations to consummate the Merger not to be satisfied. In addition to the foregoing, except as expressly contemplated by this Agreement and except as expressly set forth in SECTION 4.1 of the Disclosure Schedule, the Company shall not, without the prior written consent of Parent, which consent will not be unreasonably withheld, from and after the date of this Agreement:

(a) cause or permit any amendments to the Charter Documents;

(b) make any expenditures or enter into any commitment or transaction exceeding $100,000 individually or $250,000 in the aggregate or any commitment or transaction of the type described in SECTION 2.10 hereof other than in the ordinary course of business;

(c) other than repayment of indebtedness for borrowed money and other than payments in connection with the Parent/Company Litigation (including any related litigation with insurance carriers with respect to disputes as to coverage), pay, discharge, waive or satisfy, any indebtedness or any third party expense in an amount in excess of $50,000 in any one case, or $100,000 in the aggregate, or any other claim, liability, right or obligation (absolute, accrued, asserted or unasserted, contingent or otherwise), other than with respect to such other claim, liability right or obligation, the payment, discharge or satisfaction in the ordinary course of business of liabilities reflected or reserved against in the Current Balance Sheet;

(d) adopt or change accounting methods or practices (including any change in depreciation or amortization policies) other than as required by GAAP;

(e) make or change any material Tax election, adopt or change any material Tax accounting method, enter into any closing agreement, settle or compromise any material Tax claim or assessment, consent to any extension or waiver of the limitation period applicable to any Tax claim or assessment or file any amended Return unless a copy of such Return has been delivered to Parent for review a reasonable time prior to filing and Parent has approved such Return;

(f) materially revalue any of its assets (whether tangible or intangible), including without limitation writing down the value of inventory or writing off notes or accounts receivable, other than in the ordinary course of business and consistent with past practice;

(g) declare, set aside, or pay any dividends on or make any other distributions (whether in cash, stock or property) in respect of any Company Capital Stock, or split, combine or reclassify any Company Capital Stock or issue or authorize the issuance of any other securities in respect of, in lieu of or in substitution for shares of Company Capital Stock, or repurchase, redeem or otherwise acquire, directly or indirectly, any shares of Company Capital Stock (or Company Options or other rights exercisable therefor);

(h) increase the salary or other compensation payable or to become payable to any officer, director, Employee or advisor, or make any declaration, payment or commitment or obligation of any kind for the payment (whether in cash or equity) of a severance payment, termination payment, bonus or other additional salary or compensation to any such person, except payments made pursuant to written Contracts outstanding on the date hereof and disclosed in the Disclosure Schedule and except (i) compensation changes made in the ordinary course of business in connection with annual or other periodic reviews of employees below the level of Vice President and (ii) finalization and implementation of the Company s 2007 sales commission structure; provided, in that in the cases of clauses (i) and (ii) above,

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the aggregate increase in actual and/or forecasted compensation, as the case may be, will not exceed five percent (5%) of the levels of such compensation as of December 31, 2006.

(i) sell, lease, license or otherwise dispose of or grant any security interest in any of its properties or assets (whether tangible or intangible which properties or assets are material to the Company, individually or in the aggregate), including without limitation the sale of any accounts receivable of the Company, except in the ordinary course of business and consistent with past practices;

(j) make any loan to any person (other than travel advances to employees in the ordinary course of business consistent with past practice) or purchase debt securities of any person or amend the terms of any outstanding loan agreement;

(k) incur any indebtedness for borrowed money, guarantee any indebtedness of any person, issue or sell any debt securities, or guarantee any debt securities of any person;

(l) waive or release any material right or claim of the Company, including any write-off or other compromise of any account receivable of the Company, other than in the ordinary course of business consistent with past practices;

(m) other than any action taken in connection with the Parent/Company Litigation, commence or settle any lawsuit (other than claims solely for money damages), threat of any lawsuit or proceeding or material investigation against the Company other than by the payment of money;

(n) issue, grant, deliver or sell or authorize or propose the issuance, grant, delivery or sale of, or purchase or propose the purchase of, any Company Capital Stock or any securities convertible into, exercisable or exchangeable for, or subscriptions, rights, or Company Options to acquire, or other Contracts or commitments of any character obligating it to issue or purchase any such shares or other convertible securities, except for the issuance of Company Capital Stock pursuant to the exercise of outstanding Company Options;

(o) sell, lease, license or transfer to any person any rights to any Company Intellectual Property or enter into any Contract or modify any existing Contract with respect to any Company Intellectual Property with any person or with respect to any Intellectual Property of any person, (ii) purchase or license any Intellectual Property or enter into any Contract or modify any existing Contract with respect to the Intellectual Property of any person or (iii) enter into any Contract or modify any existing Contract with respect to the development of any Intellectual Property with a third party, or (iv) change pricing or royalties set or charged by the Company to its customers or licensees, or the pricing or royalties set or charged by persons who have licensed Intellectual Property to the Company, in each case, other than (x) in the ordinary course of business consistent with past practice or (y) in direct competition with Parent for a specific customer or project;

(p) enter into or amend any Contract pursuant to which any other party is granted exclusive marketing, distribution, development, manufacturing or similar rights of any type or scope with respect to any products or technology of the Company;

(q) enter into any Contract to purchase or sell any interest in real property, grant any security interest in any real property, enter into any lease, sublease, license or other occupancy agreement with respect to any real property or alter, amend, modify or terminate any of the terms of any Lease Agreements;

(r) amend, terminate or otherwise modify (or agree to do so), or knowingly violate the terms of, any of the Material Contracts;

(s) acquire or agree to acquire by merging or consolidating with, or by purchasing any assets or equity securities of, or by any other manner, any business or any corporation, partnership, association or other business organization or division thereof, or otherwise acquire or agree to acquire any assets that are material, individually or in the aggregate, to the business of the Company except for purchases of assets in the ordinary course of business within the limits set forth in SECTION 4.1(b) above;

(t) adopt or amend any Plan, enter into any employment Contract, pay or agree to pay any bonus or special remuneration to any director or Employee, or increase or modify the salaries, wage rates, or other compensation (including, without limitation, any equity-based compensation) of its Employees except payments made pursuant to written agreements outstanding on the date hereof and disclosed in SECTION 4.1(t) of the Disclosure Schedule and except as permitted by Section 4.1(g);

(u) enter into any strategic alliance, affiliate agreement or joint marketing arrangement or agreement other than as permitted by the last sentence of this SECTION 4.1;

(v) promote, demote or terminate any Employees, or encourage any Employees to resign from the Company or hire or offer to hire any Employees, other than Employees to (A) fill the open positions described on SECTION 4.1(v) of the Disclosure Schedule and (B) replace (1) any existing Employees of the Company critical to the continuing operations of the Company (as reasonably determined by the Company) who leave the Company s employ after the date of this Agreement or (2) any Employees hired pursuant to clause (A) of this sentence who leave the Company s employ after the date of this Agreement;

(w) alter, or enter into any commitment to alter, its interest in any corporation, association, joint venture, partnership or business entity in which the Company directly or indirectly holds any interest;

(x) cancel, amend or renew any material insurance policy; or

(y) take, or agree in writing or otherwise to take, any of the actions described in SECTIONS 4.1(a) through 4.1(x) hereof, or any other action that would, or would reasonably be expected to (i) prevent the Company from performing in all material respects, or cause the Company not to perform in all material respects, its covenants hereunder or (ii) cause or result in any of the conditions to Parent s obligations to consummate the Merger not to be satisfied.

Notwithstanding the foregoing or any other provision to the contrary, no provision of this Agreement is intended to require the Company, and the Company shall not be required, (i) to take any action (including making any disclosure, notification, or other communication to Parent) that the Company s Board of Directors determines in good faith, after consultation with outside legal counsel, could constitute or result in a violation of applicable antitrust, competition, or similar Laws; or (ii) to refrain from entering into, amending, or terminating strategic alliance, joint marketing, distribution, and/or revenue sharing agreements with mobile phone carriers/operators, mobile device original equipment manufacturers, advertising partners, search content providers, directory assistance providers, mobile middleware and voice solution providers, and (with respect to the Company s proposed VSearch product) business development partners so long as none of such arrangements includes exclusivity, most favored nation or other material restrictions on the Company s business.

4.2 *No Solicitation.* Until the earlier of (i) the Effective Time, or (ii) the date of termination of this Agreement pursuant to the provisions of SECTION 8.1 hereof, the Company shall not (nor shall the Company permit, as applicable, any of its officers, directors, Employees, Stockholders, agents, representatives or affiliates to), directly or indirectly, take any of the following actions with any party other than Parent and its designees: (a) solicit, encourage, seek, entertain, support, assist, initiate or participate in any inquiry, negotiations or discussions, or enter into any Contract, with respect to any offer or proposal to acquire all or any part of the business, properties or technologies of the Company (other than transactions in the ordinary course of the Company s business consistent with past practices), or any amount of the Company Capital Stock (whether or not outstanding), whether by merger, purchase of assets, tender offer, license or otherwise, or effect any such transaction, (b) disclose any information not customarily disclosed to any person concerning the business, technologies or properties of the Company, or afford to any person access to its properties, technologies, books or records, not customarily afforded such access, (c) assist or cooperate with any person to make any proposal to purchase all or any part of the Company Capital Stock or assets (other than inventory in the ordinary course of business) of the Company, or (d) enter into any Contract with any person providing for the acquisition of the Company, whether by merger, purchase of assets, license, tender offer or otherwise. The Company shall immediately cease and cause to be terminated any such negotiations, discussion or agreements (other than with Parent) that are the subject matter of clause (a), (b), (c) or (d) above. In the event that the Company or any of the Company s affiliates shall receive, prior to the Effective Time or the termination of this Agreement in accordance with SECTION 8.1 hereof, any offer, proposal, inquiry or request, directly or indirectly, related to any matter provided in clause (a), (c), or (d) above, or any request for disclosure or access as referenced in clause (b) above, the Company shall immediately (x) suspend any discussions with such offeror or party with regard to such offers, proposals, or requests and (y) notify Parent thereof, including information as to the identity of the offeror or the party making any such offer or proposal and the specific terms of such offer or proposal, as the case may be, and such other information related thereto as Parent may reasonably request. The parties hereto agree that irreparable damage would occur in the event that the provisions of this SECTION 4.2 were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed by the parties hereto that Parent shall be entitled to an immediate injunction or injunctions, without the necessity of proving the inadequacy of money damages as a remedy and without the necessity of posting any bond or other security, to prevent breaches of the provisions of this SECTION 4.2 and to enforce specifically the terms and provisions hereof in any court of the United States or any state having jurisdiction, this being in addition to any other remedy to which Parent may be entitled at law or in equity. Without limiting the foregoing, it is understood that any violation of the restrictions set forth above by any officer, director, agent, Employee, representative or affiliate of the Company shall be deemed to be a breach of this Agreement by the Company.

4.3 *Procedures for Requesting Parent Consent.* If the Company desires to take an action that would be prohibited pursuant to SECTION 4.1 of this Agreement without the written consent of Parent, prior to taking such action the Company may request such written consent by sending an e-mail or facsimile to both of the following individuals:

(a) Richard Palmer, Senior Vice President Corporate Development
Telephone: (781) 565-5041
Facsimile: (781) 565-5001
E-mail address: richard.palmer@nuance.com

(b) Garrison R. Smith, Director, Corporate Legal Services
Telephone: (781) 565-5277
Facsimile: (781) 565-5562
E-mail address: garrison.smith@nuance.com

Parent will respond to any such e-mail or facsimile (affirmatively or negatively) as promptly as practicable, but in any event within two (2) Business Days, or if Parent fails to so respond, Parent will be conclusively deemed to have given its written consent to the matter(s) referred to in the Company s e-mail or facsimile.

ARTICLE V

ADDITIONAL AGREEMENTS

5.1 *Registration Statement, Information Statement; Stockholder Approval.*

(a) As soon as practicable after the date hereof:

(i) Parent shall prepare and file with the SEC the Registration Statement. Parent shall cooperate and provide the Company (and its counsel) with a reasonable opportunity to review and comment on the Registration Statement and any amendment or supplement thereto prior to filing the same with the SEC. The Company shall provide Parent with such information concerning it that may be required or appropriate for inclusion in the Registration Statement, or in any amendments or supplements thereto. Parent will use all commercially reasonable efforts to cause the Registration

Statement to be declared effective under the Securities Act as promptly as practicable after such filing and to keep the Registration Statement effective as long as is necessary to consummate the Merger and the transactions contemplated hereby.

(ii) The Company shall use its commercially reasonable efforts to (i) obtain the Sufficient Stockholder Vote approving this Agreement and the transactions contemplated hereby, including the Merger, and (ii) seek approval from the Stockholders, in accordance with the requirements of Section 280G(b)(5)(B) of the Code, for any payments and/or benefits that may separately or in the aggregate, constitute parachute payments pursuant to Section 280G of the Code (SECTION 280G PAYMENTS), as determined by the Company, such that such payments and benefits shall not be deemed to be Section 280G Payments, either at a meeting of the Company s Stockholders or pursuant to a written stockholder consent, all in accordance with Delaware Law and the Charter Documents. In connection with such meeting of Stockholders or written stockholder consent, the Company shall submit to the Stockholders the Notice Materials and the Soliciting Materials (as defined below), which shall (a) include a solicitation of the approval of the holders of the Company Capital Stock to this Agreement and the transactions contemplated hereby, including the Merger, (b) specify that adoption of this Agreement shall constitute approval by the Stockholders of the appointment of Stata Venture Partners as Stockholder Representative, under and as defined in this Agreement, (c) include a summary of the Merger and this Agreement, (d) include the proxy statement included in the Registration Statement and (e) include a statement that appraisal rights are available for the Company Capital Stock pursuant to Section 262 of Delaware Law and a copy of such Section 262. Any materials to be submitted to the Stockholders in connection with the solicitation of their approval of the Merger and this Agreement (the SOLICITING MATERIALS) shall be subject to review and approval of Parent and shall also include the unanimous recommendation of the Board of Directors of the Company in favor of the Merger and this Agreement and the transactions contemplated hereby, and the determination of the Company s Board of Directors that that the terms and conditions of the Merger are fair to, and in the best interests of, the Stockholders. Parent will promptly provide all information relating to its business and operations necessary for inclusion in the Soliciting Materials to satisfy all requirements of applicable state and federal securities Laws. The Company shall cooperate and provide Parent (and its counsel) with a reasonable opportunity to review and comment on the Soliciting Materials and any amendment or supplement thereto prior submission of such materials to the Stockholders.

(b) If the Company shall seek to obtain the Sufficient Stockholder Vote by way of a meeting of the Stockholders, the Company shall consult with Parent regarding the date of such meeting to approve this Agreement and the Merger (the COMPANY STOCKHOLDERS MEETING) and shall not postpone or adjourn (other than for absence of a quorum or to the extent necessary to ensure that any necessary supplement or amendment to the Soliciting Materials is provided to its Stockholders in advance of the Company Stockholders Meeting) the Company Stockholders Meeting without the consent of Parent. In the event the Company shall seek to obtain the Sufficient Stockholder Vote by written consent, immediately upon receipt of written consents of its Stockholders constituting the Sufficient Stockholder Vote, the Company shall deliver notice of the approval of the Merger by written consent of the Company s Stockholders, pursuant to the applicable provisions of Delaware Law (the STOCKHOLDER NOTICE), to all Stockholders that did not execute such written consent informing them that this Agreement and the Merger were adopted and approved by the Stockholders of the Company and that appraisal rights are available for their Company Capital Stock pursuant to Section 262 of Delaware Law (which notice shall include a copy of such Section 262), and shall promptly inform Parent of the date on which the Stockholder Notice was sent. Notwithstanding the foregoing, the Company shall give Stockholders sufficient notice to the effect that no Stockholder will be able to exercise appraisal rights if such Stockholder has not perfected such appraisal rights in accordance with Section 262 of Delaware Law.

(c) Parent shall use commercially reasonable efforts to cause the shares of Parent Common Stock to be issued in connection with the Merger to be approved for listing on Nasdaq, subject to official notice of issuance, as promptly as practicable after the date hereof, and in any event, prior to the Closing Date.

5.2 *Access to Information.* The Company shall afford Parent reasonable access during the period from the date hereof and prior to the Effective Time to: (i) a list of Employees by function, including the major responsibilities of each such Employee (ii) officers and other employees of the Company for discussion regarding core operational processes for post-Closing integration planning and (iii) officers and other employees of the Company for limited technical discussions to facilitate post-Closing technical architecture integration.

5.3 *Confidentiality.* Each of the parties hereto hereby agrees that the information obtained in any investigation pursuant to SECTION 5.2 hereof, or pursuant to the negotiation and execution of this Agreement or the effectuation of the transactions contemplated hereby, shall be governed by the terms of the Confidential Disclosure Agreement and the New NDA. In this regard, the Company acknowledges that the Parent Common Stock is publicly traded and that any information obtained by Company regarding Parent could be considered to be material non-public information within the meaning of federal and state securities Laws. Accordingly, the Company acknowledges and agrees not to engage in any transactions in the Parent Common Stock in violation of applicable insider trading Laws. All information disclosed to Parent or its accountants, counsel, or other representatives, or to which any of them is given access, shall be deemed covered by and subject to the provisions of the New NDA.

5.4 *Expenses.* Whether or not the Merger is consummated, all fees and expenses incurred in connection with the Merger including, without limitation, all legal, accounting, financial advisory, consulting, and all other fees and expenses of third parties (including any costs incurred to obtain consents, waivers or approvals as a result of the compliance with SECTION 5.6 hereof, but excluding one-half of the $795,000 in transaction bonuses disclosed on Section 2.10 of the Disclosure Schedule) incurred by a party in connection with the negotiation and effectuation of the terms and conditions of this Agreement and the transactions contemplated hereby (THIRD PARTY EXPENSES), shall be the obligation of the respective party incurring such fees and expenses. The Company shall provide Parent with a statement of estimated Third Party Expenses incurred by the Company at least two (2) Business Days prior to the Closing Date in form reasonably satisfactory to Parent, which statement shall be accompanied by invoices from the Company s legal, financial and other advisors providing services in connection with the negotiation and effectuation of the terms and conditions of this Agreement and the transactions contemplated hereby reflecting such advisors final billable Third Party Expenses (the STATEMENT OF EXPENSES). If it is determined after the Closing that the Third Party Expenses of the Company exceed the Third Party Expenses set forth in the Statement of Expenses, the amount of such excess (EXCESS THIRD PARTY EXPENSES), shall be subject to the provisions of ARTICLE VII.

5.5 *Public Disclosure.* Prior to the Closing or any termination of this Agreement, no party shall issue any statement or communication to any third party (other than their respective directors, officers, Employees, and advisers on a need-to-know basis) regarding the subject matter of this Agreement or the transactions contemplated hereby without the consent of the other party, except that this restriction shall be subject to Parent s obligation to comply with applicable securities Laws and the rules of Nasdaq. If Parent believes it has any obligation to make any such statement or communication, it will first consult with the Company and will use commercially reasonable efforts to minimize any adverse effect of such statement or communication.

5.6 *Consents.* The Company shall use commercially reasonable efforts to obtain the consents, waivers and approvals which are listed in SECTION 2.5 of the Disclosure Schedule under the caption Material Third Party Consents (the MATERIAL THIRD PARTY CONSENTS) in a form reasonably acceptable to Parent. In the event that the other parties to any such Contract, including lessor or licensor of any Leased Real Property, conditions its grant of a consent, waiver or approval (including by threatening to exercise a recapture or other termination right) upon the payment of a consent fee, profit sharing payment or other consideration, including increased rent payments or other payments under the Contract, the Company shall be responsible for making all payments required to obtain such consent, waiver or approval and such amounts shall be deemed Third Party Expenses under SECTION 5.4 hereof.

5.7 *Firpta Compliance.* On the Closing Date, the Company shall deliver to Parent a properly executed statement (a FIRPTA COMPLIANCE CERTIFICATE) in a form reasonably acceptable to Parent for purposes of satisfying Parent s obligations under Treasury Regulation Section 1.1445-2(c)(3).

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5.8 *Reasonable Efforts; Regulatory Filings.*

(a) Subject to the terms and conditions provided in this Agreement, the Company and Parent shall use commercially reasonable efforts to take promptly, or cause to be taken, all actions, and to do promptly, or cause to be done, all things necessary, proper or advisable under applicable Laws to consummate and make effective the transactions contemplated hereby, to satisfy the conditions to the obligations to consummate the Merger, to obtain all necessary waivers, consents and approvals and to effect all necessary registrations and filings in order to consummate and make effective the transactions contemplated by this Agreement for the purpose of securing to the parties hereto the benefits contemplated by this Agreement; provided, however, that Parent shall not be required to agree to any divestiture by Parent or the Company or any of Parent s subsidiaries or affiliates, of shares of capital stock or of any business, assets or property of Parent or its subsidiaries or affiliates, of shares of capital stock or of any business, assets or property of Parent or its subsidiaries or affiliates, or of the Company, its affiliates, or the imposition of any material limitation on the ability of any of them to conduct their businesses or to own or exercise control of such assets, properties and stock.

(b) As soon as may be reasonably practicable, the Company and Parent each shall file with the United States Federal Trade Commission and the Antitrust Division of the United States Department of Justice Notification and Report Forms relating to the transactions contemplated herein as required by the HSR Act, as well as comparable pre-merger notification forms required by the merger notification or control Laws of any applicable jurisdiction, as reasonably agreed by the parties to be required, and shall promptly respond to any requests for further information from the authorities with which any such forms are filed. The Company and Parent each shall promptly supply the other with any information which may be required in order to effectuate such filings.

5.9 *Parent Notification of Certain Matters.* Parent shall use commercially reasonable efforts to give prompt notice to the other of the occurrence or non-occurrence of any event which occurrence or non-occurrence is likely to cause the conditions to the Company s obligations to consummate the Merger not to be satisfied; provided, however, that the delivery of any notice pursuant to this SECTION 5.9 shall not (a) limit or otherwise affect any remedies available to the Company hereunder or (b) constitute an acknowledgment or admission of a breach of this Agreement. No disclosure by Parent pursuant to this SECTION 5.9 shall be deemed to amend or supplement the Parent Disclosure Schedule or prevent or cure any misrepresentations, breach of warranty or breach of covenant.

5.10 *Additional Documents and Further Assurances.* Each party hereto, at the request of another party hereto, shall execute and deliver such other instruments and do and perform such other acts and things as may be necessary or desirable for effecting completely the consummation of the Merger and the transactions contemplated hereby.

5.11 *New Employment Arrangements.* Between the date of this Agreement and the Closing, Parent and the Company s CEO will jointly approach (individually and/or in one or more groups) the Company s employees to discuss the terms and conditions on which Parent proposes to continue the employment of each such employee after the Closing. Parent will have no obligation to offer continued employment or any particular terms of employment to any such employee after the Closing, and no such employee will have any obligation to agree to remain employed or to any particular terms of continued employment. All communications with the Company s employees will be done by the Company and Parent cooperatively, constructively, and proactively, with a view to preserving the integrity of the Company s organization and the morale of its employees.

5.12 *Termination of 401(k) Plan.* Effective as of the day immediately preceding the Closing Date, each of the Company and any ERISA Affiliate shall terminate any and all Company Employee Plans intended to include a Code Section 401(k) arrangement (each, a 401(K) PLAN) (unless Parent provides written notice to the Company that such 401(k) Plans shall not be terminated). Unless Parent provides such written notice to the Company, no later than five (5) Business Days prior to the Closing Date, the Company shall provide Parent with evidence that such Company

Employee Plan(s) have been terminated (effective as of the day immediately preceding the Closing Date) pursuant to resolutions of the Board of Directors of the Company or such Affiliate, as the case may be. The form and substance of such resolutions shall be subject to the reasonable review and approval of Parent. The Company also shall take such other actions in furtherance of terminating such Company Employee Plan(s) as Parent may reasonably require. In the event that termination of a 401(k) Plan would reasonably be anticipated to trigger liquidation charges, surrender charges or other fees then the Company shall take such actions as are necessary to reasonably estimate the amount of such charges and/or fees and provide such estimate in writing to Parent no later than fifteen (15) calendar days prior to the Closing Date and such charges and fees shall not constitute Third Party Expenses. Notwithstanding the foregoing or any other provision of this Agreement, at or before the time of such termination the Company shall be permitted to amend its 401(k) Plan(s) if and as necessary to permit the distribution and rollover of promissory notes evidencing outstanding participant loans of Employees, without default of such loan, to a tax qualified defined contribution plan maintained or established by the Parent, and the Parent shall cause such plan to accept such rollovers.

5.13 *Financials.* On the date of this Agreement or as soon as practicable thereafter, the Company shall deliver or cause to be delivered to Parent the unaudited balance sheet as of March 31, 2007, and the related unaudited statement of income, cash flow and stockholders equity for the three (3) month period then ended. The financial statements delivered pursuant to this SECTION 5.13 shall have been reviewed by the Company s independent accountants in accordance with SAS-100.

(a) Within thirty (30) days following the last day of each fiscal quarter ending after March 31, 2007 and after the date of this Agreement, the Company shall deliver, or cause to be delivered, to Parent the unaudited balance sheet as of the last day of such fiscal quarter, and the related unaudited statement of income, cash flow and stockholders equity for the three (3) month period then ended, in each case, reviewed by the Company s independent accountants in accordance with SAS-100.

(b) Promptly following completion of the audit of the Year-End Financials for the Company s 2006 fiscal year (the 2006 AUDIT), the Company shall deliver to Parent the audited consolidated balance sheets as of December 31, 2006 and the related consolidated statements of income, cash flow and stockholders equity for the twelve (12) month period then ended. The parties agree that at initial delivery the customer concentration footnote to such financial statements will be redacted, but that such redaction shall be reversed as soon as necessary to timely comply with the requirements of Form S-4.

5.14 *Indemnification and Insurance.*

(a) From and after the Effective Time, Parent and the Surviving Entity will fulfill and honor in all respects the obligations of the Company to indemnify its present and former directors, officers, employees, and agents and their heirs, devisees, legatees, executors, and assigns. The certificate of incorporation and bylaws of the Surviving Corporation will contain provisions with respect to indemnification, contribution, advancement of expenses, and elimination of liability for monetary damages at least as favorable to directors, officers, employees, and agents of the Surviving Corporation as those set forth in the certificate of incorporation and bylaws of the Company as of the date hereof, which provisions will not be amended, repealed, or otherwise modified for a period of six years from the Effective Time in any manner that would adversely affect the rights of any person benefited thereby, except to the extent that such modification is required by law.

(b) After the Effective Time Parent and the Surviving Corporation will, to the fullest extent permitted under applicable law, indemnify and hold harmless each present or former director or officer of the Company (collectively, the COMPANY INDEMNIFIED D&O PERSONS) against any costs or expenses (including attorneys fees), judgments, fines, losses, claims, damages, liabilities and amounts paid in settlement in connection with any claim, action, suit, proceeding or investigation, whether civil, criminal, administrative or investigative, to the extent arising out of or pertaining to any actual or alleged action or omission in his or her capacity as a director, officer, employee, or agent of the Company occurring prior to the Effective Time (including without limitation actions or omissions relating to this

Agreement and/or the Merger) for a period of six years after the date hereof. The right to indemnification hereunder will include the right to advancement of expenses as incurred in connection with any indemnifiable claim, in advance of any resolution thereof, subject to repayment if it ultimately is finally determined by a court of competent jurisdiction that the person who received such advances was not entitled to indemnification. In the event that any claim or claims for indemnification are asserted or made within such six-year period, all rights to indemnification in respect of any such claim or claims will continue until the disposition of any and all such claims.

(c) Parent shall purchase a directors and officers insurance tail policy under the Company s existing directors and officers insurance policy which (i) has an effective term of six (6) years from the Effective Time, (ii) covers the Company Indemnified D&O Persons, (iii) contains terms and conditions (including, without limitation, coverage amounts) that are no less advantageous, when taken as a whole, to those currently applicable to the Company Indemnified D&O Persons, (iv) has a total cost not in excess of $100,000 and (v) has a coverage effective date not later than the Closing Date.

5.15 *Disclosure Supplements.*

(a) From time to time before the Closing Date the Company shall supplement the Disclosure Schedules (and the information and materials provided to Parent s legal counsel) to disclose any matter hereafter arising that, if existing or occurring at or before the date of this Agreement, would have been required to be set forth or described in the Disclosure Schedule (or required to be provided to Parent s legal counsel), or that is necessary to correct any information in the Disclosure Schedule (or required to be provided to Parent s legal counsel) that is or has become inaccurate. For avoidance of doubt, the Company shall only supplement the Disclosure Schedules to reflect matters arising after the date of this Agreement.

(b) If the matter or matters, if any, included in any such disclosure supplement, individually or in the aggregate would cause a failure of the condition set forth in SECTION 6.2(a) and the Merger closes, then notwithstanding anything to the contrary in this Agreement, Parent and Sub shall not be entitled to indemnification from the Stockholders in respect of such matter or matters included in such disclosure supplement.

(c) If the matter or matters, if any, included in any such disclosure supplement, would not individually or in the aggregate cause a failure of the condition set forth in SECTION 6.2(a), the Company may, in it sole discretion deliver to Parent written authorization to terminate this Agreement by written notice to the Company delivered within five (5) Business Days following the delivery of such authorization to Parent in the same manner and with the same force and effect as if the matter or matters so disclosed had caused a failure of the condition in SECTION 6.2(a).

(d) If, following a disclosure supplement pursuant to SECTION 5.15(c)the Company authorizes Parent to terminate this Agreement pursuant to SECTION 5.15(c) and Parent does not so terminate this Agreement and the Merger closes, then notwithstanding anything to the contrary in this Agreement, Parent and Sub shall not be entitled to indemnification from the Stockholders in respect of such matter or matters included in such disclosure supplement.

(e) If, following a disclosure supplement pursuant to SECTION 5.15(c), the Company does not authorize Parent to terminate this Agreement pursuant to SECTION 5.15(c) and the Merger closes, such disclosure supplement shall not affect the rights of Parent and Sub to indemnification for the matter or matters included in such disclosure supplement.

5.16 *Non-Disparagement.* From the date of this Agreement until the earlier of the Effective Time and the termination of this Agreement, Parent and the Company will not (except in the course of any Parent/Company Litigation, to which this SECTION 5.16 shall not apply), and will cause their respective affiliates, officers, directors, employees and representatives not to, disparage, deprecate, or make any negative comment with respect to the business, operations, properties, assets, technologies, products or services of the other party.

5.17 *Stockholder Arrangements.* The Company shall take any and all actions necessary to terminate, without cost or obligation to the Company, (a) the Amended and Restated Investor Rights Agreement, dated as of September 30, 2002, by and among the Company and the parties named therein, as amended, (b) the Amended and Restated Voting

Rights Agreement, dated as of September 30, 2002, by and among the Company and the parties named therein, as amended, (c) the Amended and Restated Registration Rights Agreement, dated as of September 30, 2002, by and among the Company and the parties named therein, as amended, (d) the Second Amended and Restated Stockholders Agreement, dated as of September 30, 2002, by and among the Company and the parties named therein, as amended, and (e) any other agreements among the Company and its stockholders (collectively, the STOCKHOLDER ARRANGEMENTS). The agreements to terminate the Stockholder Arrangements will be in forms reasonably acceptable to Parent and will provide that following the Effective Time, neither the Surviving Corporation nor Parent will have any obligations or liabilities under the Stockholder Arrangements.

ARTICLE VI

CONDITIONS TO THE MERGER

6.1 *Conditions to Obligations of Each Party to Effect The Merger.* The respective obligations of the Company, on the one hand, and Parent and Sub on the other hand, to effect the Merger shall be subject to the satisfaction, at or prior to the Effective Time, of the following conditions:

(a) *No Order.* No Governmental Entity shall have enacted, issued, promulgated, enforced or entered any Law, decree, injunction or other order (whether temporary, preliminary or permanent) that is in effect and that has the effect of making the Merger illegal or otherwise prohibiting consummation of the Merger.

(b) *No Injunctions or Restraints; Illegality.* No temporary restraining order, preliminary or permanent injunction or other order issued by any court of competent jurisdiction or other legal restraint or prohibition preventing the consummation of the Merger shall be in effect, nor shall any proceeding brought by an administrative agency or commission or other Governmental Entity or instrumentality, domestic or foreign, seeking any of the foregoing be threatened or pending.

(c) *Stockholder Approval.* Stockholders constituting the Sufficient Stockholder Vote shall have approved this Agreement, and the transactions contemplated hereby, including the Merger and the appointment of the Stockholder Representative.

(d) *Registration Statement Effective.* The SEC shall have declared the Registration Statement effective. No stop order suspending the effectiveness of the Registration Statement or any part thereof shall have been issued.

(e) *Hsr Act.* The waiting period (and any extension thereof) applicable to the Merger under the HSR Act and any comparable notification statutes of foreign jurisdictions where the parties have made such notification shall have been terminated or shall have expired.

(f) *Nasdaq Listing.* The shares of Parent Common Stock to be issued in connection with the Merger shall have been approved for listing on Nasdaq, subject to official notice of issuance.

6.2 *Conditions to The Obligations of Parent and Sub.* The obligations of Parent and Sub to consummate the Merger shall be subject to the satisfaction at or prior to the Effective Time of each of the following conditions, any of which may be waived, in writing, by Parent and Sub:

(a) *Representations, Warranties and Covenants.* (i) The representations and warranties of the Company in this Agreement (disregarding, for this purpose, all exceptions in those representations and warranties relating to materiality, Company Material Adverse Effect or any similar standard or qualification) shall be true and correct on and as of the date of this Agreement and as of the Effective Time as though made on and as of the Effective Time (except to the extent expressly made as of a specified date, in which case as of such date), except where such failure to be so true and correct has not had or is not reasonably likely to have, individually or in the aggregate, a Company Material Adverse Effect (it being understood and agreed that, for the purposes of determining whether this condition has been satisfied with respect to the representation and warranty set forth in SECTION 2.14(k), Company Material Adverse Effect shall be deemed to include any material restraint or restriction on Parent s ability to conduct its business or other adverse effect on Parent), and (ii) the Company shall have performed and complied in all material respects with all covenants and obligations under this Agreement required to be performed and complied with by the Company as of the Closing.

(b) *Governmental Approval.* Approvals from any court, administrative agency, commission, or other federal, state, county, local or other foreign Governmental Entity, instrumentality, agency, or commission (if any) deemed appropriate or necessary by Parent shall have been timely obtained.

(c) *No Material Adverse Effect.* There shall not have occurred any event or condition of any character that has had or is reasonably likely to have a Company Material Adverse Effect since the date of this Agreement.

(d) *Certificate of The Company.* Parent shall have received a certificate, validly executed by the Chief Executive Officer of the Company for and on the Company s behalf, to the effect that, as of the Closing the conditions set forth in SECTION 6.2(a) have been satisfied in full.

(e) *Certificate of Secretary of Company.* Parent shall have received a certificate, validly executed by the Secretary of the Company, certifying (i) as to the terms and effectiveness of the Charter Documents, (ii) as to the valid adoption of resolutions of the Board of Directors of the Company (whereby the Merger and the transactions contemplated hereunder were unanimously approved by the Board of Directors) and (iii) that the Stockholders constituting the Sufficient Stockholder Vote have approved this Agreement and the consummation of the transactions contemplated hereby.

(f) *Third Party Consents.* The Company shall have obtained the Material Third Party Consents and shall have delivered copies thereof to Parent.

(g) *Stockholder Arrangements.* The Company shall have terminated the Stockholder Arrangements in accordance with SECTION 5.17 and shall have delivered to Parent evidence of such termination in forms reasonably acceptable to Parent.

6.3 *Conditions to Obligations of The Company.* The obligations of the Company and each of the Stockholders to consummate the Merger shall be subject to the satisfaction at or prior to the Effective Time of each of the following conditions, any of which may be waived, in writing, exclusively by the Company:

(a) *Representations, Warranties and Covenants.* (i) The representations and warranties of Parent and Sub in this Agreement (disregarding for this purpose all exceptions in those representations and warranties relating to materiality or Parent Material Adverse Effect or any similar standard or qualification) shall be true and correct on and as of the date of this Agreement and as of the Effective Time as though made on and as of the Effective Time (except to the extent expressly made as of a specified date, in which case as of such date), except where such failure to be so true and correct has not had or is not reasonably likely to have, individually or in the aggregate, a Parent Material Adverse Effect and (ii) each of Parent and Sub shall have performed and complied in all material respects with all covenants and obligations under this Agreement required to be performed and complied with by such parties as of the Closing.

(b) *Parent Material Adverse Effect.* There shall not have occurred any event or condition of any character that has had or is reasonably likely to have a Parent Material Adverse Effect since the date of this Agreement.

(c) *Certificate of Parent.* Company shall have received a certificate, validly executed on behalf of Parent by an authorized officer for and on its behalf to the effect that, as of the Closing the conditions set forth in SECTION 6.3(a) have been satisfied in full.

ARTICLE VII

SURVIVAL OF REPRESENTATIONS AND WARRANTIES

7.1 *Survival of Representations, Warranties and Covenants.* The representations and warranties of Parent, Sub and the Company contained in this Agreement, or in any certificate or other instruments delivered pursuant to this Agreement, shall survive for a period of twelve (12) months following the Closing Date (the expiration of such twelve (12) month period, the Survival Date ; provided, however, that if, at any time prior to the close of business on the twelve (12) month anniversary of the Closing Date, a Parent Officer s

Certificate (as defined in Section 7.5(b)) or a Stockholder Representative s Certificate (as defined in Section 7.5(c)) is delivered alleging Losses (as defined in Section 7.2) and a claim for recovery under this Article VII, then the claim asserted in such notice shall survive the twelve (12) month anniversary of the Closing Date until such claim is fully and finally resolved.

7.2 *Stockholder Obligations for Indemnification.* Subject the limitations set forth in this Agreement, if the Merger is consummated, each of the Stockholders, severally agrees to indemnify and hold Parent and its officers, directors, and affiliates, including the Surviving Corporation (the PARENT INDEMNIFIED PARTIES), harmless against all claims, losses, liabilities, damages, deficiencies, costs and expenses, including reasonable attorneys fees and expenses of investigation and defense and diminution in value (other than any diminution in value to the extent caused by any business interruption, loss of future revenue, cash flows or profits), but excluding any punitive or special damages, and excluding any damages caused by business interruption or loss of future revenue, cash flows or profits or loss of business reputation or opportunity (hereinafter individually a LOSS and collectively LOSSES) incurred or sustained by the Parent Indemnified Parties, or any of them (including the Surviving Corporation), directly or indirectly, as a result of (i) any breach or inaccuracy of a representation or warranty of the Company contained in this Agreement or in any certificate or other instruments delivered by or on behalf of the Company pursuant to this Agreement; provided, however, that for purposes of determining the amount of any Loss or Losses incurred or sustained as a result of any breach or inaccuracy of any representation or warranty of the Company, all exceptions in such representation or warranty relating to materiality, Company Material Adverse Effect or any similar standard or qualification shall be disregarded, (ii) any failure by the Company to perform or comply with any covenant applicable to it contained in this Agreement, (iii) the amount of any Excess Third Party Expenses, or (iv) the amount of any Dissenting Share Payments; but in the case of indemnification by the Stockholders, in the case of each of them only for his or its Pro Rata Portion of such Losses. The Stockholders shall not have any right of contribution from the Surviving Corporation or Parent with respect to any Loss claimed by a Parent Indemnified Party

7.3 *Parent Obligations for Indemnification.* Subject the limitations set forth in this Agreement, if the Merger is consummated, Parent agrees to indemnify and hold the Stockholders (the STOCKHOLDER INDEMNIFIED PARTIES) harmless against any Loss or Losses incurred or sustained by the Stockholder Indemnified Parties, or any of them, directly or indirectly as a result of: (i) any breach or inaccuracy of a representation or warranty of Parent or Sub contained in this Agreement or in any certificate or other instruments delivered by or on behalf of Parent or Sub pursuant to this Agreement; provided, however, that for purposes of determining the amount of any Loss or Losses incurred or sustained as a result of any breach or inaccuracy of any representation or warranty of Parent or Sub, all exceptions in such representation or warranty relating to materiality, Parent Material Adverse Effect or any similar standard or qualification shall be disregarded or (ii) any failure by Parent or Sub to perform or comply with any covenant applicable to either of them contained in this Agreement,

7.4 *Escrow Arrangements.*

(a) *Escrow Fund.* Promptly after the Effective Time, Parent shall deposit with the Escrow Agent the Escrow Amount out of the aggregate Cash Consideration otherwise deliverable to the Stockholders pursuant to SECTION 1.7 hereof and shall confirm such deposit with the Escrow Agent. Such deposit of the Escrow Amount shall constitute an escrow fund (the ESCROW FUND) to be governed by the terms set forth herein. The Escrow Fund shall be security for the indemnity obligations provided for in SECTION 7.2 hereof. The Escrow Fund shall be available to compensate the Parent Indemnified Parties for any claims by such parties for any Losses suffered or incurred by them and for which they are entitled to recovery under this ARTICLE VII. The Escrow Agent may execute this Agreement following the date hereof and prior to the Closing, and such later execution, if so executed after the date hereof, shall not affect the binding nature of this Agreement as of the date hereof between the other signatories hereto. Interests in the Escrow Fund shall be non-transferable.

(b) *Escrow Period; Distribution Upon Termination of Escrow Periods.* Subject to the following requirements, the Escrow Fund shall be in existence immediately following the Effective Time and shall terminate at

5:00 p.m., New York time on the day following the Survival Date (the ESCROW PERIOD); provided, however, that the Escrow Period shall not terminate with respect to any amount which, in the reasonable judgment of Parent, is or may be necessary to satisfy any unsatisfied claims specified in any Officer s Certificate delivered to the Escrow Agent and the Stockholder Representative prior to the Escrow Period termination date with respect to facts and circumstances existing prior to the Survival Date. As soon as all such claims have been resolved in accordance with SECTION 7.5, the Escrow Agent shall cause transfer of the remaining portion of the Escrow Fund not required to satisfy such claims to the Stockholders. Deliveries of amounts out of the Escrow Fund to the Stockholders pursuant to this SECTION 7.4(b) shall be made in proportion to their respective Pro Rata Portions of the remaining Escrow Fund. With Respect to Escrow payments that are payable to Stockholders designated as Optionholders on Exhibit E, the Escrow Agent shall remit to the Surviving Corporation the aggregate amount allocable to such Stockholders. As soon as practicable after the Surviving Corporation s receipt of any such remittance, Parent shall cause the Surviving Corporation to pay the respective amount to each such designated Stockholder, less any required federal, state, local and foreign Tax withholding amounts, which Parent shall cause to be paid to the applicable taxing authorities and which shall be treated for all other purposes under this Agreement as distributed in respect of the respective shares of Company Capital Stock.

(c) *Protection of Escrow Fund.*

(i) The Escrow Agent shall hold and safeguard the Escrow Fund during the Escrow Period and shall hold and dispose of the Escrow Fund only in accordance with the terms of this SECTION 7.4(c).

(ii) The parties hereto agree to provide the Escrow Agent and the Exchange and Paying Agent with a certified tax identification number by signing and returning a Form W-9 (or appropriate Form W-8 in case of non-U.S. persons) to the Escrow Agent and the Exchange and Paying Agent, upon the execution and delivery of this Agreement. The parties understand that, in the event their tax identification numbers are not certified to the Escrow Agent and the Exchange and Paying Agent, the Internal Revenue Code, as amended from time to time, may require withholding of a portion of the proceeds payable hereunder.

7.5 *Indemnification Claims.*

(a) *Basket.* Notwithstanding any provision of this Agreement to the contrary, except as set forth in the second sentence of this SECTION 7.5(a), a Parent Indemnified Party may not recover any Losses under SECTION 7.2 until the aggregate amount of all indemnifiable Losses under all claims of all Parent Indemnified Parties shall be in excess of $3,000,000 (the BASKET), at which time, subject to the other limitations set forth in this Agreement, all Losses incurred in excess of $500,000 (the DEDUCTIBLE) (including the $2,500,000 difference between the Deductible and the Basket) shall be subject to indemnification hereunder. Notwithstanding the foregoing, subject to the other limitations set forth in this Agreement, a Parent Indemnified Party shall be entitled to recover for, and neither the Deductible nor the Basket shall not apply as a threshold to, any and all claims or payments made with respect to all Losses incurred pursuant to clauses (ii), (iii), and (iv) of SECTION 7.2 hereof.

(b) *Parent Indemnified Parties Claims for Indemnification.* In order to seek indemnification under SECTION 7.2, Parent shall deliver a Parent Officer s Certificate to the Stockholder Representative and the Escrow Agent at any time on or before the last day of the Escrow Period. Unless the Stockholder Representative shall have delivered a Stockholder Objection Notice pursuant to SECTION 7.5(d) hereof, the Escrow Agent shall promptly, and in no event later than the thirtieth (30th) day after its receipt of the Officer s Certificate, deliver to the Parent Indemnified Party from the Escrow Fund an amount equal to the Loss set forth in such Officer s Certificate. Any payment from the Escrow Fund to Parent Indemnified Parties shall be deemed to have been made pro rata amongst the Stockholders based on the aggregate amounts deposited into the Escrow Fund on each such Stockholder s behalf. For the purposes hereof, PARENT OFFICER S CERTIFICATE shall mean a certificate signed by any officer of Parent: (1) stating that an Indemnified Party has paid, sustained, incurred, or properly accrued, or reasonably anticipates that it will have to pay, sustain, incur, or accrue Losses, and (2) specifying in reasonable detail the individual items of Losses included in the amount so stated, the date each such item was paid, sustained, incurred, or properly accrued, or the basis for such anticipated liability, and the nature of the misrepresentation, breach of warranty or covenant to which such item is related.

(c) *Stockholder Indemnified Parties Claims for Indemnification.* In order to seek indemnification under SECTION 7.3, the Stockholder Representative shall deliver a Stockholder Representative Certificate to Parent at any time on or before the last day of the Escrow Period. Unless Parent shall have delivered a Parent Objection Notice pursuant to SECTION 7.5(e) hereof, Parent shall promptly, and in no event later than the thirtieth (30th) day after its receipt of the Stockholder Representative Certificate, deliver in accordance with the written instructions of the Stockholder Representative, which instructions shall be conclusively binding upon the Stockholder Indemnified Part(y)(ies) and may be relied upon by Parent, for distribution to the Stockholder Indemnified Part(y)(ies) an amount equal to the Loss set forth in such Stockholder Representative s Certificate. Any such payment shall be made either by wire transfer or check, as the Stockholder Representative may direct in its written instructions to Parent. For the purposes hereof, STOCKHOLDER REPRESENTATIVE S CERTIFICATE shall mean a certificate signed by the Stockholder Representative: (1) stating that a Stockholder Indemnified Party has paid, sustained, incurred, or properly accrued, or reasonably anticipates that it will have to pay, sustain, incur, or accrue Losses, and (2) specifying in reasonable detail the individual items of Losses included in the amount so stated, the date each such item was paid, sustained, incurred, or properly accrued, or the basis for such anticipated liability, and the nature of the misrepresentation, breach of warranty or covenant to which such item is related.

(d) *Objections to Parent Indemnified Parties Claims for Indemnification.* No such payment shall be made under SECTION 7.5(b) if the Stockholder Representative shall object in a written statement to the claim made in the Parent Officer s Certificate (a STOCKHOLDER OBJECTION NOTICE), and such Stockholder Objection Notice shall have been delivered to Parent and the Escrow Agent prior to the expiration of the thirtieth (30th) day after its receipt of the Parent Officer s Certificate. If the Stockholder Representative does not to object in writing within such 30-day period, such failure to so object shall be an irrevocable acknowledgment by the Stockholder Representative that the Indemnified Party is entitled to the full amount of the claim for Losses set forth in such Parent Officer s Certificate, and payment in respect of such Losses shall thereafter be made in accordance with this SECTION 7.5.

(e) *Objections to Stockholder Indemnified Parties Claims for Indemnification.* No such payment shall be made under SECTION 7.5(c) if Parent shall object in a written statement to the claim made in the Stockholder Representative s Certificate (a PARENT OBJECTION NOTICE), and such Parent Objection Notice shall have been delivered to the Stockholder Representative prior to the expiration of the thirtieth (30th) day after its receipt of the Stockholder Representative s Certificate. If Parent does not to object in writing within such 30-day period, such failure to so object shall be an irrevocable acknowledgment by Parent that the Stockholder Indemnified Part(y)(ies) is/are entitled to the full amount of the claim for Losses set forth in such Stockholder Representative s Certificate, and payment in respect of such Losses shall thereafter be made in accordance with this SECTION 7.5.

(f) *Resolution of Conflicts.*

(i) In case the Stockholder Representative delivers a Stockholder Objection Notice in accordance with SECTION 7.5(d) or Parent delivers a Parent Objection Notice in accordance with SECTION 7.5(e), the Stockholder Representative and Parent shall attempt in good faith to agree upon the rights of the respective parties with respect to each of such claims. If the Stockholder Representative and Parent should so agree, a memorandum setting forth such agreement shall be prepared and signed by both parties and, in the case of a Parent Objection Notice, furnished to the Escrow Agent. The Escrow Agent shall be entitled to rely on any such memorandum and make distributions from the Escrow Fund in accordance with the terms thereof.

(ii) If, after thirty (30) days after delivery of a Stockholder Objection Notice or a Parent Objection Notice, as the case may be, no such agreement can be reached after good faith negotiation, either Parent, on the one hand, or the

Stockholder Representative on the other hand, may seek any remedy available to it in law or equity, subject to the terms of this Agreement, including SECTION 9.8 hereof.

(g) *Third-Party Claims.*

(i) In the event Parent or the Stockholder Representative becomes aware of a third party claim (a THIRD PARTY Claim) which the party becoming aware of such Third Party Claim reasonably believes may result in a demand for indemnification pursuant to this ARTICLE VII, such party shall notify the other party of such claim, and in the case of a Third Party Claim of which Parent becomes aware, Parent shall also notify the Escrow Agent.

(ii) If the Third Party Claim may result in a claim against the Escrow Fund, the Stockholder Representative on behalf of the Stockholders, shall be entitled, at its expense, to participate in, but not to determine or conduct, the defense of such Third Party Claim. Parent shall have the right in its sole discretion to conduct the defense of, and to settle, any such claim; provided, however, that except with the consent of the Stockholder Representative, no settlement of any such Third Party Claim with third party claimants shall be determinative of the amount of Losses relating to such matter. In the event that the Stockholder Representative has consented to any such settlement, the Stockholders shall have no power or authority to object to the amount of any Third Party Claim by Parent.

(iii) If the Third Party Claim may result in an obligation of Parent to indemnify the Stockholder Indemnified Parties, Parent shall be entitled, at its expense, to participate in, but not to determine or conduct, the defense of such Third Party Claim. The Stockholder Representative shall have the right in its sole discretion to conduct the defense of, and to settle, any such claim; provided, however, that except with the consent of Parent, no settlement of any such Third Party Claim with third party claimants shall be determinative of the amount of Losses relating to such matter.

(iv) Notwithstanding anything to the contrary in this SECTION 7.5(g), if a Third Party Claim is not reasonably likely to result in Losses in an aggregate amount greater than one hundred fifty percent (150%) the maximum obligation remaining pursuant to this Agreement of either Parent to indemnify the Stockholder Indemnified Parties on the one hand (in the case of indemnification sought from Parent) or the Stockholders to indemnify the Parent Indemnified Parties on the other hand (in the case of indemnification sought from the Stockholders), then the party from whom indemnification is being sought pursuant to this SECTION 7.5 shall have the right in its sole discretion to conduct the defense of, and to settle, any such claim; provided, however, that without the prior written consent of the indemnified party, the indemnifying party shall not agree to any settlement of any such Third Party Claim that does not include a full and unconditional release of the indemnified party.

(h) Escrow Agent s Duties.

(i) The Escrow Agent shall be obligated only for the performance of such duties as are specifically set forth herein, and as set forth in any additional written escrow instructions which the Escrow Agent may receive after the date of this Agreement that are signed by an officer of Parent and the Stockholder Representative and are not inconsistent with the terms of this Agreement, or, in the reasonable opinion of Escrow Agent, will not result in additional obligations or liabilities to the Escrow Agent, and may rely and shall be protected in relying or refraining from acting on any instrument reasonably believed to be genuine and to have been signed or presented by the proper party or parties. The Escrow Agent s duties hereunder are ministerial in nature and shall not be deemed fiduciary. The Escrow Agent shall not be liable for any act done or omitted hereunder as Escrow Agent while acting in good faith and in the exercise of reasonable judgment, and any act done or omitted pursuant to the advice of legal counsel shall be conclusive evidence of such good faith.

(ii) The Escrow Agent is hereby expressly authorized to disregard any and all warnings given by any of the parties hereto or by any other person, excepting only orders or process of courts of law, and is hereby expressly authorized to comply with and obey orders, judgments or decrees of any court. In case the Escrow Agent obeys or complies with any such order, judgment or decree of any court, the Escrow Agent shall not be liable to any of the parties hereto or to any other person by reason of such compliance, notwithstanding any such order, judgment or decree being subsequently reversed, modified, annulled, set aside, vacated or found to have been entered without jurisdiction.

(iii) The Escrow Agent shall not be liable in any respect on account of the identity, authority or rights of the parties executing or delivering or purporting to execute or deliver this Agreement or any documents or papers deposited or called for hereunder.

(iv) The Escrow Agent shall not be liable for the expiration of any rights under any statute of limitations with respect to this Agreement or any documents deposited with the Escrow Agent.

(v) In performing any duties under this Agreement, the Escrow Agent shall not be liable to any party for damages, losses, or expenses, except for gross negligence or willful misconduct on the part of the Escrow Agent. The Escrow Agent shall not incur any such liability for (A) any act or failure to act made or omitted in good faith, or (B) any action taken or omitted in reliance upon any instrument, including any written statement or affidavit provided for in this Agreement that the Escrow Agent shall in good faith believe to be genuine, nor will the Escrow Agent be liable or responsible for forgeries, fraud, impersonations, or determining the scope of any representative authority. In addition, the Escrow Agent may consult with legal counsel in connection with performing the Escrow Agent s duties under this Agreement and shall be fully protected in any act taken, suffered, or permitted by him/her in good faith in accordance with the advice of counsel. The Escrow Agent is not responsible for determining and verifying the authority of any person acting or purporting to act on behalf of any party to this Agreement.

(vi) If any controversy arises between the parties to this Agreement, or with any other party, concerning the subject matter of this Agreement, its terms or conditions, the Escrow Agent will not be required to determine the controversy or to take any action regarding it. The Escrow Agent may hold all documents and the Escrow Fund and may wait for settlement of any such controversy by final appropriate legal proceedings or other means as, in the Escrow Agent s discretion, may be required, despite what may be set forth elsewhere in this Agreement. In such event, the Escrow Agent will not be liable for damages. Furthermore, the Escrow Agent may at its option, file an action of interpleader requiring the parties to answer and litigate any claims and rights among themselves. The Escrow Agent is authorized to deposit with the clerk of the court all documents and the Escrow Fund held in escrow, except all costs, expenses, charges and reasonable attorney fees incurred by the Escrow Agent due to the interpleader action (the AGENT INTERPLEADER EXPENSES) and which the parties agree to pay as follows: fifty percent (50%) to be paid by Parent and fifty percent (50%) to be paid by the Stockholders on the basis of the Stockholders respective Pro Rata Portions; provided, however, that in the event any Stockholder fails to timely pay his or her Pro Rata Portion of the Agent Interpleader Expenses, the parties agree that Parent may at its option pay such Stockholder s Pro Rata Portion of the Agent Interpleader Expenses and recover an equal amount (which shall be deemed a Loss) from such Stockholder s Pro Rata Portion of the Escrow Fund. Upon initiating such action, the Escrow Agent shall be fully released and discharged of and from all obligations and liability imposed by the terms of this Agreement.

(vii) The parties and their respective successors and assigns agree jointly and severally to indemnify and hold Escrow Agent harmless against any and all losses, claims, damages, liabilities, and expenses, including reasonable costs of investigation, counsel fees, including allocated costs of in-house counsel and disbursements that may be imposed on Escrow Agent or incurred by Escrow Agent in connection with the performance of his/her duties under this Agreement, including but not limited to any litigation arising from this Agreement or involving its subject matter, other than those arising out of the gross negligence or willful misconduct of the Escrow Agent (the AGENT INDEMNIFICATION EXPENSES) as follows: fifty percent (50%) to be paid by Parent and fifty percent (50%) to be paid by the Stockholders on the basis of the Stockholders Pro Rata Portions directly from the Escrow Fund; provided, however, that in the event the Stockholders portion of the Agent Indemnification Expenses cannot be satisfied from the Escrow Fund in full, the parties agree that Parent shall pay the shortfall of such Stockholders portion of the Agent Indemnification Expenses, and shall be entitled to recover such amount from each Stockholder equal to such Stockholder s Pro Rata Portion of such amount without regard to any caps or other limits herein.

(viii) The Escrow Agent may resign at any time upon giving at least thirty (30) days written notice to the Parent and the Stockholder Representative; provided, however, that no such resignation shall become effective until the appointment of a successor escrow agent, which shall be accomplished as follows: Parent and the

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Stockholder Representative shall use their best efforts to mutually agree on a successor escrow agent within thirty (30) days after receiving such notice. If the parties fail to agree upon a successor escrow agent within such time, the Escrow Agent shall have the right to appoint a successor escrow agent authorized to do business in the State of New York or appeal to a court of competent jurisdiction to appoint a successor escrow agent and shall remain the escrow agent until such order is received. The successor escrow agent shall execute and deliver an instrument accepting such appointment and it shall, without further acts, be vested with all the estates, properties, rights, powers, and duties of the predecessor escrow agent as if originally named as escrow agent. Upon appointment of a successor escrow agent, the Escrow Agent shall be discharged from any further duties and liability under this Agreement.

(ix) The Escrow Agent is hereby authorized, in making or disposing of any investment permitted by this Agreement, or in carrying out any sale of the Escrow Fund permitted by this Agreement, to deal with itself (in its individual capacity) or with any one or more of its affiliates, whether it or such affiliate is acting as a subagent of the Escrow Agent or for any third person or dealing as principal for its own account.

(x) Notwithstanding anything to the contrary, any provision seeking to limit the liability of the Escrow Agent shall not be applicable in the event such liability arises from the gross negligence or willful misconduct of the Escrow Agent.

(xi) Notwithstanding any term appearing in this Agreement to the contrary, in no instance shall the Escrow Agent be required or obligated to distribute any of the Escrow Fund (or take other action that may be called for hereunder to be taken by the Escrow Agent) sooner than two (2) Business Days after (i) it has received the applicable documents required under this Agreement in good form, or (ii) passage of the applicable time period (or both, as applicable under the terms of this Agreement), as the case may be.

(i) *Fees.* All fees (including attorney s fees) of the Escrow Agent for performance of its duties hereunder shall be paid by Parent in accordance with the standard fee schedule of the Escrow Agent previously delivered to Parent. It is understood that the fees and usual charges agreed upon for services of the Escrow Agent shall be considered compensation for ordinary services as contemplated by this Agreement. In the event that the conditions of this Agreement are not promptly fulfilled, or if the Escrow Agent renders any service not provided for in this Agreement but that has been requested by an officer of Parent, or if the parties request a substantial modification of the terms of the Agreement, or if any controversy arises, or if the Escrow Agent is made a party to, or intervenes in, any litigation pertaining to the Escrow Fund or its subject matter, the Escrow Agent shall be reasonably compensated for such extraordinary services and reimbursed for all costs, attorney s fees, including allocated costs of in-house counsel, and expenses occasioned by such default, delay, controversy or litigation.

(j) *Successor Escrow Agents.* Any corporation or other entity into which the Escrow Agent in its individual capacity may be merged or converted or with which it may be consolidated, or any corporation or other entity resulting from any merger, conversion or consolidation to which the Escrow Agent in its individual capacity shall be a party, or any corporation or other entity to which substantially all the corporate trust business of the Escrow Agent in its individual capacity may be transferred, shall be the Escrow Agent under this Escrow Agreement without further act.

(k) *Investment of Escrow Fund.*

(i) If the Escrow Agent shall have received specific written investment instruction from Parent and Company (which shall include instruction as to term to maturity, if applicable), on a timely basis, the Escrow Agent shall invest the Escrow Fund in Eligible Investments, pursuant to and as directed in such instruction.

(ii) *Eligible Investments* shall mean (i) obligations issued or guaranteed by the United States of America or any agency or instrumentality thereof (provided that the full faith and credit of the United States is pledged in support thereof); (ii) obligations (including certificates of deposit and banker s acceptances) of any domestic commercial bank having capital and surplus in excess of $500,000,000; (iii) repurchase obligations for underlying securities of the type described in clause (i); (iv) investment in the Escrow Agent s Insured Money Market Account (IMMA). If otherwise qualified, obligations of the Escrow Agent or any of its affiliates shall qualify as Eligible Investments. Notwithstanding the foregoing, Eligible Investments shall

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be limited to those instruments readily obtainable and routinely offered by the Escrow Agent s Corporate Trust Services.

(iii) *Escrow Agent Not Responsible For Investment Decisions.* Absent its timely receipt of such specific written investment instruction from Parent and Company, the Escrow Agent shall have no obligation or duty to invest (or otherwise pay interest on) the Escrow Fund; provided, however, that in the event the Escrow Agent shall not have received such written investment instruction, the Escrow Agent shall be authorized to invest any of the Escrow Fund in the Escrow Agent s IMMA until such investment instruction is received. All earnings received from the investment of the Escrow Fund shall be credited to, and shall become a part of, the Escrow Fund (and any losses on such investments shall be debited to the Escrow Account). The Escrow Agent shall have no liability for any investment losses, including without limitation any market loss on any investment liquidated prior to maturity in order to make a payment required hereunder.

(iv) *Transaction Confirmations.* The parties hereto acknowledge that, to the extent regulations of the Comptroller of the Currency, or other applicable regulatory entity, grant the parties the right to receive individual confirmations of security transactions at no additional cost, as they occur, the parties specifically waive receipt of such confirmations to the extent permitted by law. The Escrow Agent will furnish the parties hereto with periodic cash transaction statements that include detail for all investment transactions made by the Escrow Agent hereunder.

(v) *Tax Reporting.* The Interested Parties agree that, for tax reporting purposes, Parent shall be treated as the owner of the Escrow Fund, in accordance with former Proposed Treasury Regulations Section 1.468B-8 for federal and state tax purposes while it is held by the Escrow Agent, and until such time, if ever, as it is determined that the funds are payable to Company, the Escrow Agent will report the interest or other income (the ESCROW INCOME) as earned by Parent; and the Escrow Agent shall, for each calendar year (or portion thereof) for which the Escrow Fund is so held will so report the interest earned on the Escrow Fund on Internal Revenue Service Form 1099 and corresponding state income tax forms in accordance with applicable law and regulations.

7.6 *Stockholder Representative.*

(a) By virtue of the approval of the Merger and this Agreement by the Sufficient Stockholder Vote, each of the Stockholders shall be deemed to have agreed to appoint Stata Venture Partners, LLC as its agent and attorney-in-fact (such appointment being coupled with an interest and irrevocable), as the Stockholder Representative for and on behalf of the Stockholders to give and receive notices and communications, to authorize payment to any Indemnified Party from the Escrow Fund in satisfaction of claims by any Indemnified Party, to object to or refrain from objecting to such payments, to agree to, negotiate, enter into settlements and compromises of, and demand arbitration and comply with orders of courts and awards of arbitrators with respect to such claims, to assert, negotiate, enter into settlements and compromises of, and demand arbitration and comply with orders of courts and awards of arbitrators with respect to, any other claim by any Indemnified Party against any Stockholder or by any such Stockholder against any Indemnified Party or any dispute between any Indemnified Party and any such Stockholder, in each case relating to this Agreement, the Escrow Agreement, or the transactions contemplated hereby or thereby, to withhold and expend the Stockholder Representative Fund, and to take all other actions that are either (i) necessary or appropriate in the judgment of the Stockholder Representative for the accomplishment of the foregoing or (ii) specifically mandated by the terms of this Agreement or the Escrow Agreement. Such agency may be changed by the Stockholders from time to time upon not less than thirty (30) days prior written notice to Parent; provided, however, that the Stockholder Representative may not be removed unless holders of a two-thirds interest of the Escrow Fund agree to such removal and to the identity of the substituted agent. A vacancy in the position of Stockholder Representative may be filled by the holders of a majority in interest of the Escrow Fund. No bond shall be required of the Stockholder Representative, and the Stockholder Representative shall not receive any compensation for its services. Notices or communications to or from the Stockholder Representative shall constitute notice to or from the Stockholders.

(b) The Stockholder Representative shall not be liable for any act done or omitted hereunder as Stockholder Representative except to the extent of the Stockholder Representative s own bad faith. The

Stockholders shall jointly and severally indemnify the Stockholder Representative and hold the Stockholder Representative harmless against any loss, liability or expense incurred without bad faith on the part of the Stockholder Representative and arising out of or in connection with the acceptance or administration of the Stockholder Representative s duties hereunder, including the reasonable fees and expenses of any legal counsel, accountants, and/or other advisers retained by the Stockholder Representative (STOCKHOLDER REPRESENTATIVE EXPENSES) and without limiting his rights to such indemnification, or the assets of the Stockholders to which recourse may be had in respect of such indemnification, the Stockholder Representative shall be entitled to reimbursement of all Stockholder Representative Expenses from the Escrow Fund, if, when, and to the extent otherwise deliverable to the Stockholders. The Stockholder Representative, in its capacity as the Stockholder Representative, shall have no liability for any claims for indemnification, compensation, or reimbursement under this Agreement or the Escrow Agreement. A decision, act, consent or instruction of the Stockholder Representative, including but not limited to an amendment, extension or waiver of this Agreement, shall constitute a decision of the Stockholders and shall be final, binding and conclusive upon the Stockholders; and the Escrow Agent and Parent may rely upon any such decision, act, consent or instruction of the Stockholder Representative as being the decision, act, consent or instruction of the Stockholders.

7.7 *Limitations on Liability.* Notwithstanding any other provision of this Agreement to the contrary:

(a) Except as set forth in SECTION 7.7(c) and SECTION 7.7(c) hereof, the maximum amount a Parent Indemnified Party may recover from a Stockholder individually pursuant to the indemnity set forth in SECTION 7.2 hereof for Losses shall be limited to the amounts held in the Escrow Fund with respect to such Stockholder.

(b) Except as set forth in SECTION 7.7(c) and SECTION 7.7(c) hereof, the maximum amount, in the aggregate, the Stockholder Indemnified Parties may recover from Parent and Sub pursuant to the indemnity set forth in SECTION 7.2 hereof shall be limited to an amount equal to $30 million; provided, however, that the limitations set forth in this SECTION 7.7(b) shall not apply to any failure by Parent or Sub to perform or comply with the covenants set forth in SECTION 5.14 or the obligation of Parent to deliver the Merger Consideration.

(c) Notwithstanding anything to the contrary set forth in this Agreement, nothing in this Agreement shall limit the liability of any person for indemnification hereunder in respect of Losses arising out of any actual fraud on the part of such person, but the loss of such limitations of liability shall apply only to the party who committed actual fraud and not to any other person.

(d) Subject to SECTION 7.7(c) hereof, the provisions of this ARTICLE VII and of SECTION 9.7 hereof are the sole and exclusive basis for the assertion of claims against, or the imposition of liability on, the Stockholders in connection with this Agreement, any other agreement or instrument executed or delivered pursuant to or in connection with this Agreement, or the Merger or other transactions contemplated hereby or thereby, whether based on contract, tort, statute, regulation, or otherwise. The Parent Indemnified Parties irrevocably waive and relinquish, and agree not to assert or pursue, any claim not based on the provisions of this ARTICLE VII or SECTION 9.7.

7.8 *Adjustments to Merger Consideration.* All indemnification payments made pursuant to this Agreement will be and be treated by all persons for all purposes as adjustments to the Merger Consideration.

7.9 *No Indemnification Without Closing.* In the event the Merger does not close: (i) nothing herein shall limit the liability of either party for any breach or inaccuracy of any representation, warranty or covenant contained in this Agreement or any Related Agreement, (ii) the provisions of this ARTICLE VII other than this SECTION 7.9 shall not apply and shall be of no further force or effect and (iii) the parties shall be entitled to seek any remedy available to such party in law or at equity for any such breach or inaccuracy.

ARTICLE VIII

TERMINATION, AMENDMENT AND WAIVER

8.1 *Termination.* Except as provided in SECTION 8.1 hereof, this Agreement may be terminated and the Merger abandoned at any time prior to the Closing:

(a) by unanimous agreement of the Company and Parent;

(b) by Parent or the Company if the Closing Date shall not have occurred by the date that is six months from the date of this Agreement;

(c) by Parent or the Company if: (i) there shall be a final non-appealable order of a federal or state court in effect preventing consummation of the Merger, or (ii) there shall be any Law enacted, promulgated or issued or deemed applicable to the Closing by any Governmental Entity that would make consummation of the Closing illegal;

(d) by Parent if there shall be any action taken, or any Law enacted, promulgated or issued or deemed applicable to the Merger by any Governmental Entity, that would prohibit Parent s ownership or operation of the business of the Company;

(e) by Parent if it is not in material breach of its obligations under this Agreement and there has been a breach of any representation, warranty, covenant or agreement of the Company or the Stockholders contained in this Agreement such that the conditions set forth in SECTION 6.2(a) hereof would not be satisfied and such breach has not been cured within ten (10) calendar days after written notice thereof to the Company and the Stockholder Representative; provided, however, that no cure period shall be required for a breach which by its nature cannot be cured; or

(f) by the Company if none of the Company or the Stockholders is in material breach of their respective obligations under this Agreement and there has been a breach of any representation, warranty, covenant or agreement of Parent contained in this Agreement such that the conditions set forth in SECTION 6.3(a) hereof would not be satisfied and such breach has not been cured within ten (10) calendar days after written notice thereof to Parent; provided, however, that no cure period shall be required for a breach which by its nature cannot be cured.

8.2 *Effect of Termination.* In the event of termination of this Agreement as provided in SECTION 8.1 hereof, this Agreement shall forthwith cease to be effective and there shall be no liability or obligation on the part of Parent, the Company or the Stockholders, or their respective officers, directors or stockholders, if applicable; provided, however, that each party hereto shall remain liable for any breaches of this Agreement prior to its termination; and provided further, however, that, the provisions of SECTIONS 5.3, 5.4 and 5.5 hereof, ARTICLE VII and ARTICLE IX and hereof and this SECTION 8.2 shall remain in full force and effect and survive any termination of this Agreement.

8.3 *Reimbursement of Company Expenses.* In the event this Agreement is terminated pursuant to SECTION 8.1 hereof and the Company has not committed any actual fraud in connection with this Agreement or the transactions contemplated hereby or intentionally breached any of its covenants set forth in this Agreement and the Related Agreements, Parent, shall promptly reimburse the Company for up to $1,000,000 of documented out-of-pocket costs and expenses incurred by the Company in connection with this Agreement and the transactions contemplated hereby.

8.4 *Amendment.* This Agreement may be amended by the parties hereto at any time by execution of an instrument in writing signed on behalf of the party against whom enforcement is sought. For purposes of this SECTION 8.4, the Stockholders agree that any amendment of this Agreement signed by the Stockholder Representative shall be binding upon and effective against the Stockholders whether or not they have signed such amendment.

8.5 *Extension; Waiver.* At any time prior to the Closing, Parent, on the one hand, and the Company and the Stockholder Representative, on the other hand, each in its sole discretion, may, to the extent legally allowed, but shall not be required to, (i) extend the time for the performance of any of the obligations of the other party hereto, (ii) waive any inaccuracies in the representations and warranties made to such party contained herein or in any document delivered pursuant hereto, and (iii) waive compliance with any of the covenants, agreements or conditions for the benefit of such party contained herein. Any agreement on the part of a party hereto to any such extension or waiver shall be valid only if set forth in an instrument in writing signed on behalf of such party. For purposes of this SECTION 8.5, the Stockholders agree that any extension or waiver signed by the Stockholder Representative shall be binding upon and effective against all Stockholders whether or not they have signed such extension or waiver.

ARTICLE IX

GENERAL PROVISIONS

9.1 *NOTICES.* All notices and other communications hereunder shall be in writing and shall be deemed given if delivered personally or by commercial messenger or courier service, or mailed by registered or certified mail (return receipt requested) or sent via facsimile (with acknowledgment of complete transmission, and followed up with a confirming copy by another of the foregoing methods) to the parties at the following addresses (or at such other address for a party as shall be specified by like notice); provided, however, that notices will not be deemed given until received:

(a) if to Parent or Sub, to:

Nuance Communications, Inc.
1 Wayside Road
Burlington, MA 01803
Attention: Senior Vice President Corporate Development
Facsimile No.: (781) 565-5001

with a copy (which will not constitute notice) to:

Wilson Sonsini Goodrich & Rosati, Professional Corporation
650 Page Mill Road
Palo Alto, CA 94304
Attention: Robert Sanchez, Esq.
Facsimile No.: (650) 493-6811

and to:

Wilson Sonsini Goodrich & Rosati
1700 K Street, NW, 5th Floor
Washington, DC 20006
Attention: Robert Sanchez, Esq.
Facsimile No.: (202) 993-8899

(b) if to the Company, to:

Voice Signal Technologies, Inc.
150 Presidential Way, Suite 310
Woburn, MA 01801
Attention: Damon Pender

Vice President of Finance
Facsimile: (781) 970-5300

with a copy (which will not constitute notice) sent at the same time and by the same means to:

Bingham McCutchen LLP
150 Federal Street
Boston, MA 02110
Attention: Brian Keeler, Esq.
Facsimile No.: (617) 951-8736

(c) if to the Stockholder Representative, to:

Stata Venture Partners, LLC
197 First Avenue
Needham, MA 02494

Facsimile No.: (508) 785-2318
Attention: Lee Barbieri, Managing Partner

with a copy (which will not constitute notice) sent
at the same time and by the same means to:

Bingham McCutchen LLP
150 Federal Street
Boston, MA 02110
Attention: Brian Keeler, Esq.
Facsimile No.: (617) 951-8736

(d) if to the Escrow Agent, to:

U.S. Bank National Association
Corporate Trust Services
225 Asylum Street, 23rd Floor
Hartford, CT 06103

Attention: Arthur Blakeslee
Facsimile No.: (860) 241-6881

9.2 *Interpretation.* The words include, includes and including when used herein shall be deemed in each case to be followed by the words without limitation. The table of contents and headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement.

9.3 *Counterparts.* This Agreement may be executed in one or more counterparts, all of which shall be considered one and the same agreement and shall become effective when one or more counterparts have been signed by each of the parties and delivered to the other party, it being understood that all parties need not sign the same counterpart.

9.4 *Entire Agreement;* Assignment. This Agreement, the Exhibits hereto, the Disclosure Schedule, the Related Agreements and the documents and instruments and other agreements among the parties hereto referenced herein: (i) constitute the entire agreement among the parties with respect to the subject matter hereof and supersede all prior agreements and understandings both written and oral, among the parties with respect to the subject matter hereof, including, without limitation, that certain Letter Agreement by and among the Parent and the Company dated as of April 4, 2007, (ii) are not intended to confer upon any other person any rights or remedies hereunder, except that the Stockholders are intended third party beneficiaries of this Agreement, entitled, only if the Merger closes, to enforce this Agreement, the holders of Company Unvested Options are intended third party beneficiaries of Section 1.7, entitled, only if the Merger closes to enforce their rights under such Section 1.7, and the persons entitled to indemnification and insurance pursuant to SECTION 5.14 are intended beneficiaries of that section, entitled, only if the Merger closes, to enforce their rights under such SECTION 5.14, (iii) shall not be assigned by operation of law (except pursuant to the laws of descent and distribution) or otherwise, except that Parent may assign its rights and delegate its obligations hereunder to its affiliates as long as Parent remains jointly and severally liable together with the assignee/delegee for all of Parent s obligations hereunder.

9.5 *Outside Information.* In entering into this Agreement, each of the parties is relying only on the representations, warranties, covenants, and other provisions expressly set forth in this Agreement, and not on any other representations, warranties, agreements, covenants, promises, projections (financial or otherwise), statements, or information not set forth of this Agreement (OUTSIDE INFORMATION), including without limitation any Outside Information obtained in the course of due diligence or from any investigation, presentation, data room, memorandum, negotiation, or discussion or otherwise; and no claim may be asserted, nor shall any party have any rights or obligations, in respect of any Outside Information.

9.6 *Severability.* In the event that any provision of this Agreement or the application thereof, becomes or is declared by a court of competent jurisdiction to be illegal, void or unenforceable, the remainder of this Agreement will continue in full force and effect and the application of such provision to other persons or circumstances will be interpreted so as reasonably to effect the intent of the parties hereto. The parties further agree to replace such void or unenforceable provision of this Agreement with a valid and enforceable provision that will achieve, to the extent possible, the economic, business and other purposes of such void or unenforceable provision.

9.7 *Other Remedies; Specific Performance.* Each of the remedies herein expressly conferred upon a party will be deemed cumulative with and not exclusive of any other remedy herein expressly conferred upon such party and the exercise by a party of any one such remedy will not preclude the exercise of any other such remedy and nothing in this Agreement shall be deemed a waiver by any party of any right to specific performance or injunctive relief. The parties hereto agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed that the parties shall be entitled to seek an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions hereof, this being in addition to any other remedy to which they are entitled at law or in equity, subject to any limitations imposed pursuant to the terms of this Agreement.

9.8 *Governing Law.* This Agreement shall be governed by and construed in accordance with the Laws of the Commonwealth of Massachusetts, regardless of the Laws that might otherwise govern under applicable principles of conflicts of Laws thereof. Each of the parties hereto irrevocably consents to the exclusive jurisdiction and venue of any court within Suffolk County, Commonwealth of Massachusetts, in connection with any matter based upon or arising out of this Agreement or the matters contemplated herein, agrees that process may be served upon them in any manner authorized by the Laws of the Commonwealth of Massachusetts for such persons and waives and covenants not to assert or plead any objection which they might otherwise have to such jurisdiction, venue and such process.

9.9 *Rules of Construction.* The parties hereto agree that they have been represented by counsel during the negotiation and execution of this Agreement and, therefor, waive the application of any Law, holding or rule of construction providing that ambiguities in an agreement or other document will be construed against the party drafting such agreement or document.

9.10 *Role of Bingham McCutchen LLP.* Each of the parties hereby (i) acknowledges that attorneys with the firm of Bingham McCutchen LLP have acted as legal counsel for the Stockholders in connection with this Agreement and the transactions contemplated hereby; and (ii) further acknowledges and agrees that Bingham McCutchen LLP and its attorneys may continue to provide legal counsel and representation to the Stockholders Representative, the Stockholders, or any of them, after the Closing, including in connection with claims for indemnification and any related litigation or other proceedings and any other matters arising under or in connection with this Agreement and the transactions contemplated hereby, (regardless of whether the Company or the Surviving Corporation is an adverse party); and (iii) hereby irrevocably waives, relinquishes, and agrees not to assert any rights to object to or to prevent Bingham McCutchen LLP or its attorneys from representing the Stockholders Representative, the Stockholders, or any of them, after the Closing.

Waiver of Jury Trial. EACH OF THE PARTIES HERETO HEREBY IRREVOCABLY WAIVES ALL RIGHT TO TRIAL BY JURY AND ANY ACTION, PROCEEDING OR COUNTERCLAIM (WHETHER BASED ON CONTRACT, TORT, OR OTHERWISE) ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE ACTIONS OF ANY PARTY HERETO IN NEGOTIATION, ADMINISTRATION, PERFORMANCE OR ENFORCEMENT HEREOF.

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IN WITNESS WHEREOF, Parent, Sub, the Company, the Stockholder Representative and the Escrow Agent have caused this Agreement to be signed, all as of the date first written above.

NUANCE COMMUNICATIONS, INC.

By: /s/ Paul A. Ricci

Name: Paul A. Ricci

Title: Chairman and Chief Executive Officer

VOICE SIGNAL TECHNOLOGIES, INC.

By: /s/ Richard J. Geruson

Name: Richard J. Geruson

Title: Chief Executive Officer

VICKSBURG ACQUISITION CORPORATION

By: /s/ Paul Ricci

Name: Paul Ricci

Title: Chairman and Chief Executive Officer

STOCKHOLDER REPRESENTATIVE

STATA VENTURE PARTNERS, LLC

By: Stata Venture Manager, Inc., its Manager

By: /s/ Leonard G. Barbieri

Name: Leonard G. Barbieri

Title: President

U.S. BANK NATIONAL
ASSOCIATION, AS ESCROW AGENT,

By: /s/ Arthur L. Blakeslee

Name: Arthur L. Blakeslee

Title: Vice President

Exhibit E

Merger Consideration Distribution

(i) For the purposes of this **Exhibit E**, the following terms shall have the meanings set forth below:

(1) ***Common Stock Per Share Pro Rata Factor*** shall mean the quotient obtained by dividing (A) one (1) by (B) the Total Company Participating Shares.

(2) ***Series A Per Share Pro Rata Factor*** shall mean the quotient obtained by dividing (A) the number of shares of Company Common Stock issuable immediately prior to the Effective Time upon conversion of one share of Company Series A Convertible Preferred Stock by (B) the Total Company Participating Shares.

(3) ***Series B Per Share Pro Rata Factor*** shall mean the quotient obtained by dividing (A) the number of shares of Company Common Stock issuable immediately prior to the Effective Time upon conversion of one share of Company Series B Convertible Preferred Stock by (B) the Total Company Participating Shares.

(4) ***Series C Per Share Pro Rata Factor*** shall mean the quotient obtained by dividing (A) the number of shares of Company Common Stock issuable immediately prior to the Effective Time upon conversion of one share of Company Series C Convertible Preferred Stock by (B) the Total Company Participating Shares.

(5) ***Series D Per Share Pro Rata Factor*** shall mean the quotient obtained by dividing (A) the number of shares of Company Common Stock issuable immediately prior to the Effective Time upon conversion of one share of Company Series D Convertible Preferred Stock by (B) the Total Company Participating Shares.

(6) ***Total Company Participating Shares*** means a number of shares of Company Common Stock equal to the sum of (A) the total number of shares of Company Common Stock outstanding immediately prior to the Effective Time (including, without limitation, any and all shares of Company Common Stock that are issued and outstanding immediately prior to the Effective Time upon exercise of Company Vested Options, whether such exercises are cash exercises of Company Vested Options or automatic deemed net exercises of Company Vested Options pursuant to Section 1.7(ii) of this Agreement), and (B) the total number of shares of Company Common Stock issuable immediately prior to the Effective Time upon conversion of all shares of Company Preferred Stock outstanding immediately prior to the Effective Time. (ii) Capitalized terms used in this **Exhibit E** and not defined above in Section (i) of this **Exhibit E** shall have the respective meanings ascribed to such terms in Section 1.7 of this Agreement or elsewhere in this Agreement.

(iii) Subject to and in accordance with the provisions of Section 1.7 of this Agreement, each share of Company Series A Convertible Preferred Stock issued and outstanding immediately prior to the Effective Time shall be converted into the right to receive (1) a cash payment equal to the product of (A) the Series A Per Share Pro Rata Factor and (B) the Cash Consideration, and (2) shares of Parent Common Stock equal to the product of (X) the Series A Per Share Pro Rata Factor and (Y) the Stock Consideration.

(iv) Subject to and in accordance with the provisions of Section 1.7 of this Agreement, each share of Company Series B Convertible Preferred Stock issued and outstanding immediately prior to the Effective Time shall be converted into the right to receive (1) a cash payment equal to the product of (A) the Series B Per Share Pro Rata Factor and (B) the Cash Consideration, and (2) shares of Parent Common Stock equal to the product of (X) the Series B Per Share Pro Rata Factor and (Y) the Stock Consideration.

(v) Subject to and in accordance with the provisions of Section 1.7 of this Agreement, each share of Company Series C Convertible Preferred Stock issued and outstanding immediately prior to the Effective Time shall be converted into the right to receive (1) a cash payment equal to the product of (A) the Series C Per Share Pro Rata Factor and (B) the Cash Consideration, and (2) shares of Parent Common Stock equal to the product of (X) the Series C Per Share Pro Rata Factor and (Y) the Stock Consideration.

(vi) Subject to and in accordance with the provisions of Section 1.7 of this Agreement, each share of Company Series D Convertible Preferred Stock issued and outstanding immediately prior to the Effective Time shall be converted into the right to receive (1) a cash payment equal to the product of (A) the Series D Per Share Pro Rata Factor and (B) the Cash Consideration, and (2) shares of Parent Common Stock equal to the product of (X) the Series D Per Share Pro Rata Factor and (Y) the Stock Consideration.

(vii) Subject to and in accordance with the provisions of Section 1.7 of this Agreement, each share of Company Common Stock issued and outstanding immediately prior to the Effective Time (including, without limitation, any share of Company Common Stock that is issued and outstanding immediately prior to the Effective Time upon exercise of any Company Vested Option, whether any such exercise is a cash exercise of such Company Vested Option or an automatic deemed net exercise of such Company Vested Option pursuant to Section 1.7(ii) of this Agreement) shall be converted into the right to receive (1) a cash payment equal to the product of (A) the Common Stock Per Share Pro Rata Factor and (B) the Cash Consideration, and (2) shares of Parent Common Stock equal to the product of (X) the Common Stock Per Share Pro Rata Factor and (Y) the Stock Consideration.

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ANNEX B

§ 262. Appraisal Rights

(a) Any stockholder of a corporation of this State who holds shares of stock on the date of the making of a demand pursuant to subsection (d) of this section with respect to such shares, who continuously holds such shares through the effective date of the merger or consolidation, who has otherwise complied with subsection (d) of this section and who has neither voted in favor of the merger or consolidation nor consented thereto in writing pursuant to § 228 of this title shall be entitled to an appraisal by the Court of Chancery of the fair value of the stockholder s shares of stock under the circumstances described in subsections (b) and (c) of this section. As used in this section, the word stockholder means a holder of record of stock in a stock corporation and also a member of record of a nonstock corporation; the words stock and share mean and include what is ordinarily meant by those words and also membership or membership interest of a member of a nonstock corporation; and the words depository receipt mean a receipt or other instrument issued by a depository representing an interest in one or more shares, or fractions thereof, solely of stock of a corporation, which stock is deposited with the depository.

(b) Appraisal rights shall be available for the shares of any class or series of stock of a constituent corporation in a merger or consolidation to be effected pursuant to § 251 (other than a merger effected pursuant to § 251(g) of this title), § 252, § 254, § 257, § 258, § 263 or § 264 of this title:

(1) Provided, however, that no appraisal rights under this section shall be available for the shares of any class or series of stock, which stock, or depository receipts in respect thereof, at the record date fixed to determine the stockholders entitled to receive notice of and to vote at the meeting of stockholders to act upon the agreement of merger or consolidation, were either (i) listed on a national securities exchange or designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc. or (ii) held of record by more than 2,000 holders; and further provided that no appraisal rights shall be available for any shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation as provided in subsection (f) of § 251 of this title.

(2) Notwithstanding paragraph (1) of this subsection, appraisal rights under this section shall be available for the shares of any class or series of stock of a constituent corporation if the holders thereof are required by the terms of an agreement of merger or consolidation pursuant to §§ 251, 252, 254, 257, 258, 263 and 264 of this title to accept for such stock anything except:

a. Shares of stock of the corporation surviving or resulting from such merger or consolidation, or depository receipts in respect thereof;

b. Shares of stock of any other corporation, or depository receipts in respect thereof, which shares of stock (or depository receipts in respect thereof) or depository receipts at the effective date of the merger or consolidation will be either listed on a national securities exchange or designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc. or held of record by more than 2,000 holders;

c. Cash in lieu of fractional shares or fractional depository receipts described in the foregoing subparagraphs a. and b. of this paragraph; or d. Any combination of the shares of stock, depository receipts and cash in lieu of fractional shares or fractional depository receipts described in the foregoing subparagraphs a., b. and c. of this paragraph.

(3) In the event all of the stock of a subsidiary Delaware corporation party to a merger effected under § 253 of this title is not owned by the parent corporation immediately prior to the merger, appraisal rights shall be available for the shares of the subsidiary Delaware corporation.

(c) Any corporation may provide in its certificate of incorporation that appraisal rights under this section shall be available for the shares of any class or series of its stock as a result of an amendment to its certificate of incorporation, any merger or consolidation in which the corporation is a constituent corporation or the sale of all or substantially all of the assets of the corporation. If the certificate of incorporation contains such a

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provision, the procedures of this section, including those set forth in subsections (d) and (e) of this section, shall apply as nearly as is practicable.

(d) Appraisal rights shall be perfected as follows:

(1) If a proposed merger or consolidation for which appraisal rights are provided under this section is to be submitted for approval at a meeting of stockholders, the corporation, not less than 20 days prior to the meeting, shall notify each of its stockholders who was such on the record date for such meeting with respect to shares for which appraisal rights are available pursuant to subsection (b) or (c) hereof that appraisal rights are available for any or all of the shares of the constituent corporations, and shall include in such notice a copy of this section. Each stockholder electing to demand the appraisal of such stockholder s shares shall deliver to the corporation, before the taking of the vote on the merger or consolidation, a written demand for appraisal of such stockholder s shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of such stockholder s shares. A proxy or vote against the merger or consolidation shall not constitute such a demand. A stockholder electing to take such action must do so by a separate written demand as herein provided. Within 10 days after the effective date of such merger or consolidation, the surviving or resulting corporation shall notify each stockholder of each constituent corporation who has complied with this subsection and has not voted in favor of or consented to the merger or consolidation of the date that the merger or consolidation has become effective; or

(2) If the merger or consolidation was approved pursuant to § 228 or § 253 of this title, then either a constituent corporation before the effective date of the merger or consolidation or the surviving or resulting corporation within 10 days thereafter shall notify each of the holders of any class or series of stock of such constituent corporation who are entitled to appraisal rights of the approval of the merger or consolidation and that appraisal rights are available for any or all shares of such class or series of stock of such constituent corporation, and shall include in such notice a copy of this section. Such notice may, and, if given on or after the effective date of the merger or consolidation, shall, also notify such stockholders of the effective date of the merger or consolidation. Any stockholder entitled to appraisal rights may, within 20 days after the date of mailing of such notice, demand in writing from the surviving or resulting corporation the appraisal of such holder s shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of such holder s shares. If such notice did not notify stockholders of the effective date of the merger or consolidation, either (i) each such constituent corporation shall send a second notice before the effective date of the merger or consolidation notifying each of the holders of any class or series of stock of such constituent corporation that are entitled to appraisal rights of the effective date of the merger or consolidation or (ii) the surviving or resulting corporation shall send such a second notice to all such holders on or within 10 days after such effective date; provided, however, that if such second notice is sent more than 20 days following the sending of the first notice, such second notice need only be sent to each stockholder who is entitled to appraisal rights and who has demanded appraisal of such holder s shares in accordance with this subsection. An affidavit of the secretary or assistant secretary or of the transfer agent of the corporation that is required to give either notice that such notice has been given shall, in the absence of fraud, be prima facie evidence of the facts stated therein. For purposes of determining the stockholders entitled to receive either notice, each constituent corporation may fix, in advance, a record date that shall be not more than 10 days prior to the date the notice is given, provided, that if the notice is given on or after the effective date of the merger or consolidation, the record date shall be such effective date. If no record date is fixed and the notice is given prior to the effective date, the record date shall be the close of business on the day next preceding the day on which the notice is given.

(e) Within 120 days after the effective date of the merger or consolidation, the surviving or resulting corporation or any stockholder who has complied with subsections (a) and (d) hereof and who is otherwise entitled to appraisal rights, may file a petition in the Court of Chancery demanding a determination of the value of the stock of all such stockholders. Notwithstanding the foregoing, at any time within 60 days after the effective date of the merger or consolidation, any stockholder shall have the right to withdraw such

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stockholder s demand for appraisal and to accept the terms offered upon the merger or consolidation. Within 120 days after the effective date of the merger or consolidation, any stockholder who has complied with the requirements of subsections (a) and (d) hereof, upon written request, shall be entitled to receive from the corporation surviving the merger or resulting from the consolidation a statement setting forth the aggregate number of shares not voted in favor of the merger or consolidation and with respect to which demands for appraisal have been received and the aggregate number of holders of such shares. Such written statement shall be mailed to the stockholder within 10 days after such stockholder s written request for such a statement is received by the surviving or resulting corporation or within 10 days after expiration of the period for delivery of demands for appraisal under subsection (d) hereof, whichever is later.

(f) Upon the filing of any such petition by a stockholder, service of a copy thereof shall be made upon the surviving or resulting corporation, which shall within 20 days after such service file in the office of the Register in Chancery in which the petition was filed a duly verified list containing the names and addresses of all stockholders who have demanded payment for their shares and with whom agreements as to the value of their shares have not been reached by the surviving or resulting corporation. If the petition shall be filed by the surviving or resulting corporation, the petition shall be accompanied by such a duly verified list. The Register in Chancery, if so ordered by the Court, shall give notice of the time and place fixed for the hearing of such petition by registered or certified mail to the surviving or resulting corporation and to the stockholders shown on the list at the addresses therein stated. Such notice shall also be given by 1 or more publications at least 1 week before the day of the hearing, in a newspaper of general circulation published in the City of Wilmington, Delaware or such publication as the Court deems advisable. The forms of the notices by mail and by publication shall be approved by the Court, and the costs thereof shall be borne by the surviving or resulting corporation.

(g) At the hearing on such petition, the Court shall determine the stockholders who have complied with this section and who have become entitled to appraisal rights. The Court may require the stockholders who have demanded an appraisal for their shares and who hold stock represented by certificates to submit their certificates of stock to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings; and if any stockholder fails to comply with such direction, the Court may dismiss the proceedings as to such stockholder.

(h) After determining the stockholders entitled to an appraisal, the Court shall appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with a fair rate of interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all relevant factors. In determining the fair rate of interest, the Court may consider all relevant factors, including the rate of interest which the surviving or resulting corporation would have had to pay to borrow money during the pendency of the proceeding. Upon application by the surviving or resulting corporation or by any stockholder entitled to participate in the appraisal proceeding, the Court may, in its discretion, permit discovery or other pretrial proceedings and may proceed to trial upon the appraisal prior to the final determination of the stockholder entitled to an appraisal. Any stockholder whose name appears on the list filed by the surviving or resulting corporation pursuant to subsection (f) of this section and who has submitted such stockholder s certificates of stock to the Register in Chancery, if such is required, may participate fully in all proceedings until it is finally determined that such stockholder is not entitled to appraisal rights under this section.

(i) The Court shall direct the payment of the fair value of the shares, together with interest, if any, by the surviving or resulting corporation to the stockholders entitled thereto. Interest may be simple or compound, as the Court may direct. Payment shall be so made to each such stockholder, in the case of holders of uncertificated stock forthwith, and the case of holders of shares represented by certificates upon the surrender to the corporation of the certificates representing such stock. The Court s decree may be enforced as other decrees in the Court of Chancery may be enforced, whether such surviving or resulting corporation be a corporation of this State or of any state.

(j) The costs of the proceeding may be determined by the Court and taxed upon the parties as the Court deems equitable in the circumstances. Upon application of a stockholder, the Court may order all or a portion

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of the expenses incurred by any stockholder in connection with the appraisal proceeding, including, without limitation, reasonable attorney s fees and the fees and expenses of experts, to be charged pro rata against the value of all the shares entitled to an appraisal.

(k) From and after the effective date of the merger or consolidation, no stockholder who has demanded appraisal rights as provided in subsection (d) of this section shall be entitled to vote such stock for any purpose or to receive payment of dividends or other distributions on the stock (except dividends or other distributions payable to stockholders of record at a date which is prior to the effective date of the merger or consolidation); provided, however, that if no petition for an appraisal shall be filed within the time provided in subsection (e) of this section, or if such stockholder shall deliver to the surviving or resulting corporation a written withdrawal of such stockholder s demand for an appraisal and an acceptance of the merger or consolidation, either within 60 days after the effective date of the merger or consolidation as provided in subsection (e) of this section or thereafter with the written approval of the corporation, then the right of such stockholder to an appraisal shall cease. Notwithstanding the foregoing, no appraisal proceeding in the Court of Chancery shall be dismissed as to any stockholder without the approval of the Court, and such approval may be conditioned upon such terms as the Court deems just.

(l) The shares of the surviving or resulting corporation to which the shares of such objecting stockholders would have been converted had they assented to the merger or consolidation shall have the status of authorized and unissued shares of the surviving or resulting corporation.

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ANNEX C

FORM OF
VOTING AGREEMENT

THIS VOTING AGREEMENT (this **Agreement**) is made and entered into as of May 14, 2007, by and among Nuance Communications, Inc., a Delaware corporation (**Parent**), Voice Signal Technologies, Inc., a Delaware corporation (the **Company**), and , the undersigned stockholder of the Company (**Stockholder**).

RECITALS

A. Concurrently with the execution of this Agreement, Parent, Vicksburg Acquisition Corporation, a Delaware corporation and a wholly-owned subsidiary of Parent (**Sub**), the Company and certain other parties have entered into an Agreement and Plan of Merger, dated as of May 14, 2007 (the **Merger Agreement**), which provides for the statutory merger of Sub with and into the Company (the **Merger**).

B. Pursuant to the Merger, all of the issued and outstanding shares of capital stock of the Company will be converted into the right to receive the consideration set forth in the Merger Agreement, all upon the terms and subject to the conditions set forth in the Merger Agreement.

C. Stockholder beneficially owns (as defined below) the number of outstanding shares of capital stock of the Company and other securities convertible into, or exercisable or exchangeable for, shares of capital stock of the Company, all as set forth on the signature page of this Agreement.

D. In order to induce Parent to execute the Merger Agreement, Stockholder desires to restrict the transfer or disposition of any of the Shares (as defined below), or any other shares of capital stock of the Company over which Stockholder has voting power, and desires to vote the Shares and any other such shares of capital stock of the Company over which Stockholder has voting power so as to facilitate the consummation of the Merger. The execution and delivery of this Agreement and of the attached form of proxy is a material condition to Parent s willingness to enter into the Merger Agreement.

NOW, THEREFORE, the parties hereto hereby agree as follows:

1. ***Certain Definitions.*** Capitalized terms used but not defined herein shall have the meanings ascribed to them in the Merger Agreement. For purposes of this Agreement:

(a) A Person shall be deemed to **Beneficially Own** a security if such Person, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise, has or shares: (i) voting power, which includes the power to vote, or to direct the voting of, such security; and/or (ii) investment power, which includes the power to dispose, or to direct the disposition of, such security.

(b) ***Expiration Date*** shall mean the earlier to occur of (i) such date and time as the Merger Agreement shall have been terminated pursuant to Article VIII thereof and (ii) such date and time as the Merger shall become effective in accordance with the terms and provisions of the Merger Agreement.

(c) ***Person*** shall mean any (i) individual, (ii) corporation, limited liability company, partnership or other entity, or (iii) governmental authority.

(d) ***Shares*** shall mean: (i) all equity securities of the Company (including all shares of Company Capital Stock and all options, warrants, convertible promissory notes and other rights to acquire shares of Company Capital Stock) Beneficially Owned by Stockholder as of the date of this Agreement; and (ii) all additional equity securities of the Company (including all additional shares of Company Capital Stock and all additional options, warrants, convertible promissory notes and other rights to acquire shares of Company Capital Stock) of which Stockholder acquires Beneficial Ownership during the period from the date of this Agreement through the Expiration Date.

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(e) A Person shall be deemed to have effected a **Transfer** of a security if such Person directly or indirectly: (i) sells, pledges, encumbers, grants an option with respect to, transfers or otherwise disposes of such security or any interest in such security; or (ii) enters into an agreement or commitment providing for the sale of, pledge of, encumbrance of, grant of an option with respect to, transfer of or other disposition of such security or any interest therein. Notwithstanding the foregoing, **Transfer** shall not include any transfer to a family member, a trust for the benefit of a family member, a charitable trust or a charity if the transferee agrees in writing to be bound by the terms of this Agreement.

2. ***No Transfer of Shares to be Bound by this Agreement.*** Stockholder agrees that, during the period from the date of this Agreement through the Expiration Date, Stockholder shall not cause or permit any Transfer of any Shares bound by this Agreement.

3. ***Transfer of Voting Rights.*** Stockholder agrees that, during the period from the date of this Agreement through the Expiration Date, Stockholder shall not deposit (or permit the deposit of) any Shares in a voting trust or, except for the Proxy (as defined below), grant any proxy or, except for this Agreement, enter into any voting agreement or similar agreement in contravention of the obligations of Stockholder under this Agreement with respect to any of the Shares.

4. ***Agreement to Vote Shares.*** Until the Expiration Date, at every meeting of stockholders of the Company called with respect to any of the following, and at every adjournment or postponement thereof, and on every action or approval by written consent of stockholders of the Company with respect to any of the following, Stockholder shall vote, to the extent not voted by the Person(s) appointed under the Proxy, the outstanding shares of Company Capital Stock in respect of which the Stockholder has acquired Beneficial Ownership at such times or cause such shares to be voted:

(a) in favor of approval of the Merger, the execution and delivery by the Company of the Merger Agreement and the adoption and approval of the terms thereof and in favor of each of the other actions contemplated by the Merger Agreement and any action required in furtherance thereof, which approval shall constitute approval of (i) the indemnification obligations of the stockholders of the Company set forth in Article VII of the Merger Agreement and (ii) the appointment of Stata Venture Partners, LLC as Stockholder Representative under, and as defined in, the Merger Agreement;

(b) against approval of any proposal made in opposition to, or in competition with, consummation of the Merger and the Merger Agreement;

(c) against any of the following actions (other than those actions that relate to the Merger and the transactions contemplated by the Merger Agreement): (i) any merger, consolidation, business combination, sale of assets, reorganization or recapitalization of the Company with any party, (ii) any sale, lease or transfer of any significant part of the assets of the Company, (iii) any reorganization, recapitalization, dissolution, liquidation or winding up of the Company, (iv) any material change in the capitalization of the Company or the Company s corporate structure, or (v) any other action that is intended, or could reasonably be expected to, impede, interfere with, delay, postpone, discourage or adversely affect the Merger or any of the other transactions contemplated by the Merger Agreement; and

(d) in favor of waiving any notice that may have been or may be required as a result of or relating to the Merger and the transactions contemplated by the Merger Agreement.

Prior to the Expiration Date, Stockholder shall not enter into any agreement or understanding with any Person to vote or give instructions in any manner inconsistent with this **Section 4**. Stockholder further covenants and agrees to take, or cause to be taken, any additional actions reasonably necessary to carry out the intent of this **Section 4**.

5. ***Public Disclosure.*** Stockholder shall not issue any statement or communication to any third party regarding the subject matter of the Merger Agreement or the transactions contemplated thereby, including, if applicable, the termination of the Merger Agreement and the reasons therefor, without the consent of Parent.

6. ***Irrevocable Proxy.*** Concurrently with the execution of this Agreement, Stockholder agrees to deliver to Parent an irrevocable proxy in the form attached hereto as **Exhibit 1** (the **Proxy**), which shall be irrevocable to the fullest extent permitted by applicable law, with respect to the Shares.

7. ***Appointment of Stockholder Representative.*** Stockholder agrees to appoint Stata Venture Partners, LLC as agent and attorney-in-fact for and on behalf of Stockholder for purposes of Articles I, V, VII and VIII of the Merger Agreement. Stockholder further agrees that any decision, act, consent or instruction of the Stockholder Representative, including, without limitation, any agreement by the Stockholder Representative for and on behalf of the stockholders of the Company to any amendments, modifications and waivers of any term, condition or other agreement set forth in the Merger Agreement, shall constitute a decision of Stockholder for all purposes of and under the Merger Agreement, and that such decision, act, consent or instruction shall be final, binding and conclusive upon Stockholder as if made by the Stockholder.

8. ***Representations, Warranties and Covenants of Stockholder.*** Except as otherwise disclosed in the Merger Agreement, Stockholder represents, warrants and covenants to Parent as follows:

(a) Stockholder is the Beneficial Owner of the shares of Company Capital Stock and the options and warrants to purchase shares of Company Capital Stock indicated on the signature page of this Agreement.

(b) Stockholder does not Beneficially Own any shares or rights to acquire shares of capital stock of the Company (including without limitation promissory notes that are convertible into shares of Company Capital Stock) other than the shares of Company Capital Stock and the options and warrants to purchase shares of Company Capital Stock indicated on the signature page of this Agreement.

(c) Stockholder has the full power to vote or direct the voting of the Shares for and on behalf of all beneficial owners of the Shares.

(d) As of the Effective Time, the Shares will be, free and clear (by waiver or otherwise) of any rights of first refusal, co-sale rights, security interests, liens, pledges, claims, options, charges or other encumbrances.

(e) Stockholder has full power and authority to make, enter into and carry out the terms of this Agreement and the Proxy.

This Agreement and the Proxy constitute legal, valid and binding obligations of the Stockholder enforceable in accordance with their respective terms.

9. ***Consents and Waivers.*** Stockholder hereby covenants and agrees to give any consents or waivers (including waivers of preemptive rights, rights of first refusal, co-sale rights and stock option or restricted stock vesting rights) that are reasonably required for the consummation of the Merger under the terms of any agreement to which Stockholder is a party or pursuant to any rights Stockholder may have.

10. ***Termination.*** This Agreement and the Proxy delivered in connection herewith shall terminate and shall have no further force or effect as of the Expiration Date.

11. ***Legending of Shares.*** If so requested by Parent, Stockholder agrees that the Shares shall bear a legend stating that they are subject to this Agreement and to an irrevocable proxy. Subject to the terms of **Section 2** hereof, Stockholder agrees that Stockholder will not Transfer the Shares without first having the aforementioned legend affixed to the certificates representing the Shares.

12. ***Miscellaneous.***

(a) ***Severability.*** If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction to be invalid, void or unenforceable, then the remainder of the terms, provisions, covenants and restrictions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated.

(b) ***Binding Effect and Assignment.*** This Agreement and all of the provisions hereof shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns, but,

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except as otherwise specifically provided herein, neither this Agreement nor any of the rights, interests or obligations of the parties hereto may be assigned by any of the parties without the prior written consent of the other parties.

(c) ***Amendments and Modification.*** This Agreement may not be modified, amended, altered or supplemented except by the execution and delivery of a written agreement executed by the parties hereto.

(d) ***Waiver.*** No failure on the part of Parent to exercise any power, right, privilege or remedy under this Agreement, and no delay on the part of Parent in exercising any power, right, privilege or remedy under this Agreement, shall operate as a waiver of such power, right, privilege or remedy; and no single or partial exercise of any such power, right, privilege or remedy shall preclude any other or further exercise thereof or of any other power, right, privilege or remedy. Parent shall not be deemed to have waived any claim arising out of this Agreement, or any power, right, privilege or remedy under this Agreement, unless the waiver of such claim, power, right, privilege or remedy is expressly set forth in a written instrument duly executed and delivered on behalf of Parent; and any such waiver shall not be applicable or have any effect except in the specific instance in which it is given.

(e) ***Specific Performance; Injunctive Relief.*** The parties acknowledge that Parent will be irreparably harmed and that there will be no adequate remedy at law for a violation of any of the covenants or agreements of Stockholder set forth herein. Therefore, it is agreed that, in addition to any other remedies that may be available to Parent upon any such violation, Parent shall have the right to enforce such covenants and agreements by specific performance, injunctive relief or by any other means available to Parent at law or in equity.

(f) ***Notices.*** All notices and other communications hereunder shall be in writing and shall be deemed given if delivered personally or by commercial messenger or courier service, or mailed by registered or certified mail (return receipt requested) or sent via facsimile (with acknowledgment of complete transmission) to the parties at the following addresses (or at such other address for a party as shall be specified by like notice); *provided*, *however*, that notices sent by mail will not be deemed given until received:

If to Parent:	Nuance Communications, Inc. 1 Wayside Road Burlington, MA 01803 Attention: General Counsel Facsimile No.: (781) 565-5001
With a copy to:	Wilson Sonsini Goodrich & Rosati Professional Corporation 650 Page Mill Road Palo Alto, CA 94304 Attention: Robert Sanchez, Esq. Facsimile No.: (650) 493-6811
If to Stockholder or to the Company:	To the address for notice set forth on the signature page hereof.
With a copy to Company Counsel:	Bingham McCutchen LLP 150 Federal Street Boston, MA 02110 Attention: Julio E. Vega, Esq. Facsimile No.: (617) 951-8736

(g) ***Governing Law.*** This Agreement shall be governed by, construed and enforced in accordance with the laws of the State of Delaware, without giving effect to any choice or conflict of law provision or rule (whether of the State of Delaware or any other jurisdiction) that would cause the application of the laws of any jurisdiction other than the State of Delaware.

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(h) ***Attorneys Fees and Expenses.*** If any action or other proceeding relating to the enforcement of any provision of this Agreement is brought by either party, the prevailing party shall be entitled to recover reasonable attorneys fees, costs and disbursements (in addition to any other relief to which the prevailing party may be entitled).

(i) ***Entire Agreement.*** This Agreement and the Proxy contain the entire understanding of the parties in respect of the subject matter hereof, and supersede all prior negotiations and understandings between the parties with respect to such subject matter.

(j) ***Counterparts.*** This Agreement may be executed in several counterparts, each of which shall be an original, but all of which together shall constitute one and the same agreement.

(k) ***Effect of Headings.*** The section headings herein are for convenience only and shall not affect the construction or interpretation of this Agreement.

[*Signature Page Follows*]

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IN WITNESS WHEREOF, the undersigned have executed this Agreement on the date first above written.

NUANCE COMMUNICATIONS, INC

By: – –
Name: – –
Title: – –

STOCKHOLDER:

If an individual:

Signature

Print Name

If an entity:
Print Name: – –

By: – –
Name: – –
Title: – –

VOICE SIGNAL TECHNOLOGIES, INC

By: – –
Name: – –
Title: – –

Address:

Company Capital Stock

Common Stock: – –

Preferred Stock
(specify series): – –
– –

Options to Purchase
Common Stock: – –

Warrants to Purchase
Company Capital
Stock: – –

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EXHIBIT 1

IRREVOCABLE PROXY

The undersigned stockholder (**Stockholder**) of Vicksburg, Inc., a Delaware corporation (the **Company**), hereby irrevocably (to the fullest extent permitted by law) appoints each of Richard Palmer and James Arnold of Nuance Communications, Inc., a Delaware corporation (**Parent**), as the sole and exclusive attorneys and proxies of the undersigned, with full power of substitution and resubstitution, to vote and exercise all voting and related rights (to the full extent that the undersigned is entitled to do so) with respect to all of the outstanding shares of capital stock of the Company that now are or hereafter may be beneficially owned by the undersigned and any and all other shares of or Securities of the Company issued or issuable after the date hereof (collectively, the **Shares**), in accordance with the terms of this Proxy. The Shares beneficially owned by the Stockholder as of the date of this Proxy are listed on the final page of this Proxy, along with the number(s) of the stock certificate(s) which represent such Shares. Upon the Stockholder s execution of this Proxy, any and all prior proxies given by the undersigned with respect to any Shares are hereby revoked and Stockholder agrees not to grant any subsequent proxies with respect to the Shares until after the Expiration Date (as defined below).

This Proxy is irrevocable (to the fullest extent permitted by law), is coupled with an interest and is granted pursuant to that certain Voting Agreement dated as of May 14, 2007 by and among Parent, the Company and Stockholder (the **Voting Agreement**), and is granted in consideration of Parent entering into that certain Agreement and Plan of Merger dated as of May 14, 2007 (the **Merger Agreement**), by and among Parent, Vicksburg Acquisition Corporation, a Delaware corporation and a wholly-owned subsidiary of Parent (**Sub**), the Company and certain other parties. The Merger Agreement provides for the statutory merger of Sub with and into the Company in accordance with its terms (the **Merger**), and Stockholder is receiving a portion of the proceeds of the Merger. As used in this Proxy, the term **Expiration Date** shall mean the earlier to occur of (i) such date and time as the Merger Agreement shall have been terminated pursuant to Article VIII thereof and (ii) such date and time as the Merger shall become effective in accordance with the terms and provisions of the Merger Agreement.

The attorneys and proxies named above, and each of them, are hereby authorized and empowered by Stockholder, at any time prior to the Expiration Date, to act as Stockholder s attorney and proxy to vote the Shares, and to exercise all voting, consent and similar rights of the undersigned with respect to the Shares (including, without limitation, the power to execute and deliver written consents) at every annual, special, adjourned or postponed meeting of stockholders of the Company and in every written consent in lieu of such meeting:

(i) in favor of approval of the Merger, the execution and delivery by the Company of the Merger Agreement and the adoption and approval of the terms thereof and in favor of each of the other actions contemplated by the Merger Agreement and any action required in furtherance thereof, which approval shall constitute approval of (i) the indemnification obligations of the stockholders of the Company set forth in Article VII of the Merger Agreement and (ii) the appointment of Stata Venture Partners, LLC as Stockholder Representative under, and as defined in, the Merger Agreement;

(ii) against approval of any proposal made in opposition to, or in competition with, consummation of the Merger and the Merger Agreement;

(iii) against any of the following actions (other than those actions that relate to the Merger and the transactions contemplated by the Merger Agreement): (A) any merger, consolidation, business combination, sale of assets, reorganization or recapitalization of the Company with any party, (B) any sale, lease or transfer of any significant part of the assets of the Company, (C) any reorganization, recapitalization, dissolution, liquidation or winding up of the Company, (D) any material change in the capitalization of the Company or the Company s corporate structure, or

(E) any other action that is intended, or could reasonably be expected to, impede, interfere with, delay, postpone, discourage or adversely affect the Merger or any of the other transactions contemplated by the Merger Agreement; and

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(iv) in favor of waiving any notice that may have been or may be required as a result of or relating to the Merger and the transactions contemplated by the Merger Agreement.

The attorneys and proxies named above may not exercise this Proxy on any other matter except as provided in clauses (i), (ii), (iii) or (iv) above. Stockholder may vote the Shares on all other matters.

Any obligation of Stockholder hereunder shall be binding upon the successors and assigns of Stockholder.

[remainder of page intentionally left blank]

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This Proxy shall terminate, and be of no further force and effect, automatically upon the Expiration Date.

Dated: May 14, 2007

STOCKHOLDER:

If an individual:

Signature

Print Name

If an entity:

Print Name: – –

By: – –
Name: – –
Title: – –

Company Capital Stock

Common Stock: – –

Preferred Stock
(specify series): – –
– –
Options to Purchase
Common Stock: – –

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PART II INFORMATION NOT REQUIRED IN PROSPECTUS

Item 20. *Indemnification of Officers and Directors*

Section 145(a) of the General Corporation Law of the State of Delaware (Delaware Corporation Law) provides, in general, that a corporation shall have the power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation), because the person is or was a director, officer, employee or agent of the corporation. Such indemnity may be against expenses (including attorneys fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by the person in connection with such action, suit or proceeding, if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation and if, with respect to any criminal action or proceeding, the person did not have reasonable cause to believe the person s conduct was unlawful.

Section 145(b) of the Delaware Corporation Law provides, in general, that a corporation shall have the power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor because the person is or was a director, officer, employee or agent of the corporation, against any expenses (including attorneys fees) actually and reasonably incurred by the person in connection with the defense or settlement of such action or suit if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation, subject to certain additional limitations.

Section 145(g) of the Delaware Corporation Law provides, in general, that a corporation shall have the power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation against any liability asserted against the person in any such capacity, or arising out of the person s status as such, whether or not the corporation would have the power to indemnify the person against such liability under the provisions of the law.

Article XI of the Restated Certificate of Incorporation, as amended, of the Registrant authorizes the Registrant, subject to certain limited exceptions, to indemnify its directors and officers to the fullest extent permitted by the Delaware Corporation Law. Article II, Section 6 of the Amended and Restated Bylaws of the Registrant, however, require the Registrant to indemnify its directors and officers to the fullest extent permitted by the Delaware Corporation Law. The directors and officers of the Registrant are insured under policies of insurance maintained by the Registrant, subject to the limits of the policies, against certain losses arising from any claims made against them by reason of being or having been such directors or officers. In addition, the Registrant has entered into contracts with certain of its directors providing for indemnification of such persons by the Registrant to the full extent authorized or permitted by law, subject to certain limited exceptions.

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Item 21. ***Exhibits and Financial Statement Schedules***

(a) Exhibits

EXHIBIT INDEX

		Incorporated by Reference				
Exhibit Number	**Exhibit Description**	**Form**	**File No.**	**Exhibit**	**Filing Date**	**Filed Herewith**
2.1	Agreement and Plan of Merger, by and among the Registrant, Voice Signal Technologies, Inc., Vicksburg Acquisition Corporation and Stata Venture Partners, LLC (included as Annex A to the consent solicitation statement/prospectus contained in this Registration Statement).					X
3.1	Amended and Restated Certificate of Incorporation of the Registrant.	10-Q	0-27038	3.2	5/11/2001	
3.2	Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Registrant.	10-Q	0-27038	3.1	8/9/2004	
3.3	Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Registrant, as amended.	S-3	333-142182	3.3	4/18/2007	
3.4	Certificate of Ownership and Merger.	8-K	0-27038	3.1	10/19/2005	
3.5	Amended and Restated Bylaws of the Registrant.	10-K	0-27038	3.2	3/15/2004	
4.1	Specimen Common Stock Certificate.	8-A	0-27038	4.1	12/6/1995	
4.2	Common Stock Purchase Warrant	S-4	333-70603	Annex A	1/14/1999	
4.3	Securities Purchase Agreement, dated March 19, 2004, by and among Xerox Imaging Systems, Inc., Warburg Pincus Private Equity VIII, L.P., Warburg Pincus Netherlands Private Equity VIII I C.V., Warburg Pincus Netherlands Private Equity VIII II C.V., Warburg Pincus Germany Private Equity VIII K.G., and the Registrant.	10-Q	0-27038	4.1	5/10/2004	
4.4	Stockholders Agreement, dated March 19, 2004, by and between the Registrant and Warburg Pincus Private Equity VIII, L.P., Warburg Pincus Netherlands Private Equity VIII I C.V., Warburg Pincus Netherlands Private Equity VIII II C.V., and Warburg Pincus Germany Private Equity VIII K.G.	10-Q	0-27038	4.2	5/10/2004	
4.5		10-Q	0-27038	4.3	5/10/2004	

Common Stock Purchase Warrants, dated March 15, 2004, issued to Warburg Pincus Private Equity VIII, L.P., Warburg Pincus Netherlands Private Equity VIII I C.V., Warburg Pincus Netherlands Private Equity VIII II C.V., and Warburg Pincus Germany Private Equity VIII K.G.

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Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Filed Herewith
4.6	Stock Purchase Agreement, dated as of May 5, 2005, by and between the Registrant and Warburg Pincus Private Equity VIII, L.P., Warburg Pincus Netherlands Private Equity VIII I C.V., Warburg Pincus Netherlands Private Equity VIII II C.V., and Warburg Pincus Germany Private Equity VIII K.G.	S-4/A	333-125496	Annex F	8/1/2005	
4.7	Amended and Restated Stockholders Agreement, dated May 5, 2005, by and between the Registrant and Warburg Pincus Private Equity VIII, L.P., Warburg Pincus Netherlands Private Equity VIII I C.V., Warburg Pincus Netherlands Private Equity VIII II C.V., and Warburg Pincus Germany Private Equity VIII K.G.	S-4/A	333-125496	Annex G	8/1/2005	
4.8	Common Stock Purchase Warrants, dated May 9, 2005, issued to Warburg Pincus Private Equity VIII, L.P., Warburg Pincus Netherlands Private Equity VIII I C.V., and Warburg Pincus Germany Private Equity VIII K.G.	S-4	333-125496	4.11	6/3/2005	
4.9	Securities Purchase Agreement, dated as of May 5, 2005, by and between the Registrant and Warburg Pincus Private Equity VIII, L.P., Warburg Pincus Netherlands Private Equity VIII C.V. I. and Warburg Pincus Germany Private Equity VIII K.G.	10-Q	0-27038	4.2	8/9/2005	
5.1	Legal Opinion of Wilson Sonsini Goodrich & Rosati, Professional Corporation.					X
10.1	Form of Indemnification Agreement.	S-8	333-108767	10.1	9/12/2003	
10.2	Stand Alone Stock Option Agreement Number 1, dated as of August 21, 2000, by and between the Registrant and Paul A. Ricci.*	S-8	333-49656	4.3	11/9/2000	
10.3	Gold Disk Bundling Agreement, dated as of September 30, 1999, as amended by Amendment Number 1, dated as of January 1, 2000, between the Registrant and Xerox Corporation.	10-K/A	0-27038	10.15	8/8/2001	
10.4		S-8	333-33464	10.4	3/29/2000	

	Caere Corporation 1992 Non-Employee Directors Stock Option Plan.*				
10.5	1993 Incentive Stock Option Plan, as amended.*	S-1	33-100647	10.17	10/21/2002
10.6	1995 Employee Stock Purchase Plan, as amended and restated on April 27, 2000.*	14A	0-27038	Annex D	4/13/2004
10.7	Amended and Restated 1995 Directors Stock Option Plan, as amended.*	14A	0-27038	10.2	3/17/2005
10.8	1997 Employee Stock Option Plan, as amended.*	S-1	33-100647	10.19	10/21/2002
10.9	1998 Stock Option Plan.*	S-8	333-74343	99.1	3/12/1999
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Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Filed Herewith
10.10	Amended and Restated 2000 Stock Option Plan.*	14A	0-27038	10.1	3/17/2005	
10.11	2000 NonStatutory Stock Option Plan, as amended.*	S-8	333-108767	4.1	9/12/2003	
10.12	ScanSoft 2003 Stock Plan.*	S-8	333-108767	4.3	9/12/2003	
10.13	Nuance Communications, Inc. 2001 Nonstatutory Stock Option Plan.*	S-8	333-128396	4.1	9/16/2005	
10.14	Nuance Communications, Inc. 2000 Stock Plan.*	S-8	333-128396	4.2	9/16/2005	
10.15	Nuance Communications 1998 Stock Plan.*	S-8	333-128396	4.3	9/16/2005	
10.16	Nuance Communications 1994 Flexible Stock Incentive Plan.*	S-8	333-128396	4.4	9/16/2005	
10.17	Form of Restricted Stock Purchase Agreement.*	10-K/A	0-27038	10.17	12/15/2006	
10.18	Form of Restricted Stock Unit Purchase Agreement.*	10-K/A	0-27038	10.18	12/15/2006	
10.19	Form of Stock Option Agreement.*	10-K/A	0-27038	10.19	12/15/2006	
10.20	2005 Severance Benefit Plan for Executive Officers.*	10-Q	0-27038	10.1	5/10/2005	
10.21	Officer Short-term Disability Plan.*	10-Q	0-27038	10.2	5/10/2005	
10.22	Technology Transfer and License Agreement, dated as of January 30, 2003, between Koninklijke Philips Electronics N.V. and the Registrant.	S-1/A	33-100647	10.30	2/7/2003	
10.24	Letter, dated February 17, 2003, from the Registrant to Jeanne McCann regarding certain employment matters.*	10-Q	0-27038	10.1	5/15/2003	
10.25	Employment Agreement, effective August 11, 2006, by and between the Registrant and Paul A. Ricci.*	8-K	0-27038	10.1	11/8/2006	
10.26	Employment Agreement, dated March 9, 2004, by and between the Registrant and John Shagoury.*	10-Q	0-27038	10.1	8/9/2004	
10.27	Letter, dated May 23, 2004, from the Registrant to Steven Chambers regarding certain employment matters.*	10-Q	0-27038	10.2	8/9/2004	
10.28	Letter, dated September 27, 2004, from the Registrant to James R. Arnold, Jr. regarding certain employment matters.*	10-KT	0-27038	10.39	1/6/2005	
10.29	Letter dated September 25, 2006, from the Registrant to Don Hunt regarding certain employment matters.	10-K	0-27038	10.29	12/15/2006	
21.1	Subsidiaries of the Registrant.	10-K/A	0-27038	21.1	12/15/2006	

23.1	Consent of BDO Seidman, LLP.	X
23.2	Consent of Vitale, Caturano, & Company, Ltd.	X
23.3	Consent of S.R. Batliboi & Associates.	X
23.4	Consent of PricewaterhouseCoopers LLP.	X

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Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Filed Herewith
23.5	Consent of Grant Thornton LLP.					X
23.6	Consent of Deloitte & Touche LLP.					X
23.7	Consent of Kost Forer Gabbay & Kasierer.					X
23.8	Consent of Wilson Sonsini Goodrich & Rosati, Professional Corporation (Included in Exhibit 5.1)					X
24.1	Power of Attorney (See Signature Page).					X

* Denotes management compensatory plan or arrangement.

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Item 22. ***Undertakings***

The undersigned registrant hereby undertakes:

(a) (1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

(i) To include any prospectus required by Section 10(a)(3) of the Securities Act of 1933;

(ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the Calculation of Registration Fee table in the effective registration statement;

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement;

(2) That, for the purpose of determining any liability under the Securities Act of 1933 each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

(b) That, for purposes of determining any liability under the Securities Act of 1933, each filing of the registrant s annual report pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 (and, where applicable, each filing of an employee benefit plan s annual report pursuant to Section 15(d) of the Securities Exchange Act of 1934) that is incorporated by reference into this registration statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(c) (1) That, prior to any public reoffering of the securities registered hereunder through use of a prospectus which is a part of this registration statement, by any person or party who is deemed to be an underwriter within the meaning of Rule 145(c), the issuer undertakes that such reoffering prospectus will contain the information called for by the applicable registration form with respect to reofferings by persons who may be deemed underwriters, in addition to the information called for by the other Items of the applicable form.

(2) That every prospectus (i) that is filed pursuant to paragraph (c)(1) immediately preceding, or (ii) that purports to meet the requirements of Section 10(a)(3) of the Securities Act of 1933 and is used in connection with an offering of securities subject to Rule 415, will be filed as a part of an amendment to the Registration Statement and will not be used until such amendment is effective, and that, for purposes of determining any liability under the Securities Act of 1933 each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(d) Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act of 1933 and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by

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the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act of 1933 and will be governed by the final adjudication of such issue.

(e) To respond to requests for information that is incorporated by reference into the prospectus pursuant to Item 4, 10(b), 11 or 13 of this Form, within one business day of receipt of such request, and to send the incorporated documents by first class mail or other equally prompt means. This includes information contained in the documents filed subsequent to the effective date of the registration statement through the date of responding to the request.

(f) To supply by means of a post-effective amendment all information concerning a transaction, and the company being acquired involved therein, that was not the subject of and included in the registration statement when it became effective.

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SIGNATURES

Pursuant to the requirements of the Securities Act, the registrant has duly caused this amendment no. 1 to registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Burlington, Commonwealth of Massachusetts, on August 13, 2007.

NUANCE COMMUNICATIONS, INC.

By: /s/ James R. Arnold

James R. Arnold
Chief Financial Officer

Pursuant to the requirements of the Securities Act, this amendment no. 1 to registration statement has been signed by the following persons in the capacities and on the dates indicated.

Signature	Title	Date
/s/ * Paul A. Ricci	Chairman of the Board and Chief Executive Officer (Principal Executive Officer)	August 13, 2007
/s/ James R. Arnold James R. Arnold	Chief Financial Officer (Principal Financial Officer)	August 13, 2007
/s/ * Steven E. Hebert	Chief Accounting Officer and Controller (Principal Accounting Officer)	August 13, 2007
/s/ * Robert J. Frankenberg	Director	August 13, 2007
/s/ * Katharine A. Martin	Director	August 13, 2007
/s/ * Mark B. Myers	Director	August 13, 2007
/s/ * Robert G. Teresi	Director	August 13, 2007
/s/ * William H. Janeway	Director	August 13, 2007

/s/ *	Director	August 13, 2007
Philip Quigley		
/s/ *	Director	August 13, 2007
Jeffrey A. Harris		

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Signature	Title	Date
/s/ *	Director	August 13, 2007
Charles Berger		
/s/ James R. Arnold		
James R. Arnold, as attorney-in-fact		

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